

**INSTITUTIONAL VARIETIES OF PRODUCTIVIST WELFARE CAPITALISM  
IN EAST ASIA**

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Many existing East Asian welfare studies claim that, unlike advanced capitalist societies where social welfare generally embodies the successes of social democratic politics, East Asia's social policy is strictly subordinate to the overriding policy objective of economic growth. They label this pattern as "productivist welfare capitalism" (PWC), viewing East Asian welfare states as a largely homogeneous productivist community. While acknowledging the basic features of PWC, this dissertation raises two puzzles.

The first question is whether productivist welfare states are really homogenous and converging institutionally. This study argues that, despite their longstanding state-led development strategies, East Asian capitalist states have developed markedly different sub-types of PWC. Focusing on the institutional formats, I categorize PWC into three types—(i) inclusive productivist welfare (IPW), (ii) market productivist welfare (MPW), and (iii) dualist productivist welfare (DPW). Unlike the current single-lensed productivist welfare thesis, this study asserts that, while some productivist welfare states have developed social insurance-based schemes focusing on the "risk-pooling" principle (IPW), some others have expanded individual savings-based schemes emphasizing the "self-help" principle (MPW). Also, another group has pursued these two patterns simultaneously, revealing a dualist form (DPW). I conduct cluster analysis to test this presumed variation in PWC.

The second question is why the institutional divergence has taken place and becomes increasingly apparent. Why do some productivist welfare states enter the pathway to IPW while some others choose the direction of MPW? First, this dissertation contends that economic openness (free trade and liberalized financial markets) promotes MPW because savings-based social security is fit to the realization of the “self-reliance” principle. By contrast, IPW is more significant in less open economies where the government plays a major role in the market by controlling firms and banks and protecting skilled workers through privileged risk-pooling insurance schemes. The second argument is that democratic transition and electoral competition are positively associated with the expansion of IPW policies such as national pension and health insurance schemes. To test these arguments, this study has performed cross-sectional time-series analysis on data of eleven East Asian states and then three case studies including Korea’s IPW, Singapore’s MPW, and China’s DPW.

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## 1.0 INTRODUCTION

### 1.1 PUZZLE

What is the precise nature of welfare arrangements in capitalist East Asia? Are East Asian welfare states suitably fitted into the tripartite framework of liberal, conservative, and social democratic models presented in Esping-Andersen's (1990) *Three Worlds of Welfare Capitalism*? If not, is there an overarching East Asian welfare model, just as many Asian scholars think of social policy in East Asia as being primarily "productivist" (Holliday 2000)? If the so-called "productivist" model is compelling and acceptable, what are the main characteristics of this model? Is this model equally applicable to all the newly industrialized economies (NIEs) in the region? In other words, is it fair to assume that the institutional characteristics of productivist welfarism appear mostly identical among East Asian NIEs? If not, is there systematic variation within the productivist paradigm? What are the driving forces behind the variation if any?

Although there are many *inter*-regional comparative analyses that highlight contrasting features between East Asia and other parts of the world, few studies are interested in *intra*-regional variation of East Asian welfare regime. Unlike many other comparative studies, this dissertation aims to show that, despite their common nature as productivist welfare states, East Asian NIEs have not advanced toward the same pattern, and that they have rather evolved into three different types of productivist welfarism. To test this argument, this study first develops

three sub-models of productivist welfarism and then investigates conditions under which the divergence has occurred.

In fact, the question of East Asian welfare capitalism is by no means new to the existing literature. The surge of research interest in East Asia has grown considerably over the last two decades.<sup>1</sup> This interest started with attempts to explain how East Asian NIEs have successfully managed to combine remarkable economic dynamism with low rates of taxation and welfare spending while exhibiting impressive achievements on key quality-of-life indicators such as infant mortality, life expectancy, and literacy. Indeed, East Asia's welfare expenditures—measured either as a percent of GDP or as a percent of total government spending—are much lower than those of Europe and Latin America (Haggard and Kaufman 2008; Segura-Ubiergo 2007).

What is distinctive, however, is not only the fact that they spend less but also the pattern of social policy they have developed. Unlike other advanced capitalist societies where social security is the major policy area of public expenditure, most East Asian states spend more on human capital formation (e.g., education and job training) while being relatively reluctant to spend on other “protective” areas (e.g., pension, health, social assistance). Without doubt, East Asian NIEs emphasize the “productive” function of social policy while being less committed to the provision of “protective” social programs (Rudra 2008). The primacy of this productivist tendency has attracted considerable research interest and provided important scholarly insights to those like Holliday (2000) who proposed the so-called “productivist welfare capitalism” (PWC).

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<sup>1</sup> This unique experience has even propelled ideological debates between right- and left-wing politicians in the West. For example, the Labor Party in Britain viewed East Asia as a role model in its emphasis on the active role of the

It is unquestionable that, as an exercise in East Asian “exceptionalism,” the PWC theory offers a compelling account of East Asia’s welfare state development (Peng and Wong 2010, 658).<sup>2</sup>

The main argument of PWC is that social policy in East Asia is not considered as a means of social protection per se but rather often used as an important policy instrument to promote labor productivity, human capital accumulation, and economic growth. The theoretical foundation of PWC is the belief that “protective” welfare measures hamper economic growth—one of the most important national goals in East Asia. Because welfare programs require greater tax revenue, the expansion of social welfare leads to the rise of overall production costs and, as a consequence, the economy becomes less competitive in the global market. So, East Asian states put the policy priority on lowering labor costs, resisting any forms of “traditional” welfare benefits. Instead, they pursue their own version of social welfare based on the “productivist” principle of (i) minimal social rights with extensions linked to productive activities, (ii) underpinning of the position of productive elements (e.g., education and job training), and (iii) state-market-family relationships directed towards economic growth. In short, economy is the essence of social welfare in the productivist context and, therefore, social policy is “strictly subordinated to the overriding policy objective of economic growth” in East Asia (Holliday 2000, 708).

Undeniably, the productivist model reflects the key nature of East Asian welfare capitalism, highlighting regionally bounded differences that distinguish East Asia from other parts of the world. However, despite the common stress on economic growth and the government’s limited role in funding, the patterns of adoption and extension of PWC are not uniform in East Asia. Certainly, one can find significant variation and considerable dynamism of

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<sup>2</sup> Chapter 2 provides further explanation about PWC.

East Asian welfare regime, especially in terms of institutional platforms of PWC (Peng and Wong 2010, 658). Some productivist welfare states develop compulsory *social insurance* schemes focusing on “risk-pooling” among workers, while some others foster mandatory *individual savings* schemes emphasizing “self-reliance.” Also, another productivist group adopts a *dualist* approach, embracing both *social insurance* (“risk-pooling”) and *individual savings* (“self-reliance”) schemes.

Questions rise here again: is this presumed variation systematic? Is there empirical evidence convincing us to accept the above three categories of East Asian PWC? If they are acceptable, how can we refine the existing theoretical discourse of PWC so as to analyze the divergence and dynamism of productivist welfare? More importantly, what causal factors are behind institutional variation within the productivist world?

## **1.2 ARGUMENTS IN BRIEF**

### **1.2.1 Three Models of PWC**

To develop a theoretical model of East Asian welfare states, Holliday (2000) proposes the so-called “productivist welfare capitalism” (PWC). It offers a captivating account of welfare state evolution in East Asia, viewing the provision of social security benefits as being subordinated to the imperatives of labor production, human capital formation, and sustainable economic growth. However, despite the continuity and steadiness of its productivist credentials that can be explained by the longstanding state-led development strategy, the institutional design and implementation of PWC are not identical in the region (Kwon 2009). This variation began in the



post-war years and has become more significant since the 1997 Asian financial crisis. Indeed, the financial crisis was a momentous watershed not only because it hit the region hard and wide but also because it led many of the East Asian states to realize the need and importance of social protection. For example, the expansion of social insurance schemes and public assistance programs becomes more prominent in Japan, South Korea (hereafter Korea), and Taiwan, while compulsory individual savings schemes play a leading role in Singapore, Malaysia, and Hong Kong. Unlike these two groups, China and Thailand are deliberately pursuing a mixed system, combining social insurance and individual savings.

Given this presumed variation, the current single-lensed productivist welfare thesis seems not nuanced enough to address the question of whether and why East Asian productivist welfare states have cultivated different patterns of social policy development. Hence, it is necessary to refine the existing PWC theory tailored to the dynamism of East Asian productivist welfare states. To this end, I propose three subcategories of PWC.

The first model is what I call *inclusive productivist welfare* (IPW). It highlights the characteristic of “risk-pooling” embedded in social insurance schemes and public assistance programs. But it is worth noticing at the outset that, although social insurance and public assistance have redistributive functions, the use of risk-pooling in this model is not for the protection of social rights per se but rather for the creation of a socioeconomic circumstance conducive to economic growth. In other words, the primary goal of risk-pooling in the productivist context is not redistribution itself but economic development primarily. Indeed, in many East Asian states, “inclusive” benefits of risk-pooling used to be selectively provided to state employees and industrial workers who were considered central to the economy. Consequently, a great portion of the vulnerable population who really needed social protection

was often left outside the social security system. This indicates that the lion's share of social insurance benefits was primarily for middle/upper-income groups who could make significant contributions to the economy, especially during the early years of industrialization. Even though some IPW states have extended insurance coverage later to all their citizens and by doing so appear as if they have been fundamentally transformed into a “protective” welfare state, it is misleading to see this simply as a progressive and profound shift from productivist welfare to, say, social democratic welfare. It is because the extension of social security benefits in IPW states is often part of a grand economic strategy to reduce any negative effects of economic liberalization. Japan, Korea, and Taiwan are typical examples of this model.

The second model is what I call *market productivist welfare* (MPW). This model aims to construct a social security system based on “individual”—not “socially pooled”—savings arrangements. Just as the inclusive model views social policy as a tool for economic development, so does the market-oriented approach. But, whereas the former underlines positive impacts of risk-pooling on sustainable economic growth, the latter is pessimistic about the effect of risk-pooling, because any redistributive arrangements are believed to bring financial burdens to the government and ultimately hurt market-efficiency. However, this does not mean that MPW states totally ignore the need or importance of social security net. Instead of adopting an inclusive method, they construct their own model—a mandatory *savings* arrangement—that focuses on market-efficiency. In this “self-reliance” system, workers (and their employers) shoulder all financial responsibilities for their own social security. Because benefits are linked entirely to individual contributions, there is neither risk-pooling nor deficits and therefore the government can be free from any financial commitments. Examples of this market-oriented PWC model include Singapore, Hong Kong, and Malaysia.

The last model is what I call *dualist productivist welfare* (DPW). Unlike the above two models, dualist states pursue both IPW (risk-pooling through social insurance) and MPW (self-reliance through mandatory individual savings) simultaneously. The DPW model is believed to be an optimal strategy for economic growth, particularly in countries that have large socioeconomic gaps between manufacturing and agricultural sectors (or between urban and rural areas). States with the dualist approach tend to develop “market-oriented” measures for *less productive* rural residents while establishing “inclusive” programs for *more productive* urban workers. The DPW states provide risk-pooling insurance benefits to industrial/urban areas while leaving rural residents to self-help system.<sup>3</sup> As such, the prominent features of DPW include (i) the combination of social funds and individual savings in social security schemes and (ii) the sector-specific (or region-specific) fragmentation of social security program. China and Thailand exemplify the DPW pattern.

### 1.2.2 Economic Openness

I argue that East Asian productivist welfare states have been diverging into three broad categories—IPW, MPW, and DPW. If this divergence is systematic and robust, our next task should be to analyze the major factors driving the cross-national variation. My argument rests upon the assumption that, if the productivist world of welfare capitalism has experienced an institutional divergence, the temporal and spatial variation is an outcome of changes in the initial economic and political conditions that had shaped PWC in each country. Based upon this

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<sup>3</sup> IPW states (Japan, Korea, and Taiwan) have extended standardized social insurance programs to the entire population. So have MPW states (Singapore, Hong Kong, and Malaysia) done with their individual savings schemes. By contrast, DPW states provide different regions and industries with different institutional forms of social security.

assumption, this study examines the impact of economic openness and political pressure as a set of independent variables.

Although most East Asian economies have been industrialized under the flagship of a strong state and export-led strategies, they actually showed significant differences in the extent and form of exposure to the global economy (Wan 2008). Indeed, different levels of reliance on foreign capital and trade have resulted in different economic structures, nurturing different types of social security institution. For example, Singapore and Hong Kong have been engaged in “market-conforming” developmental strategies (e.g., open financial markets) whereas Japan, Korea, and Taiwan pursued “market-distorting” developmental strategies (e.g., closed financial markets) during the industrialization period (Wade 1990, 28). This difference created distinctive initial conditions under which economic globalization has brought different impacts on productivist welfare states. That is, there existed “strategic complementarities” between economic openness and welfare provision (Ebbinghaus and Manow 2001, 10-11).<sup>4</sup>

Unquestionably, market-oriented measures are prone to be adopted in “market-conforming” economies. Because open economies are more vulnerable to the interest of foreign investors, one of their most important policy tasks is to create a pro-business environment attractive to foreign investment. An individual savings-based social security platform is fit to this purpose since it is conducive to the realization of self-reliance. As such, productivist welfare states with a higher level of economic liberalization tend to develop more market-oriented social policies (MPW).

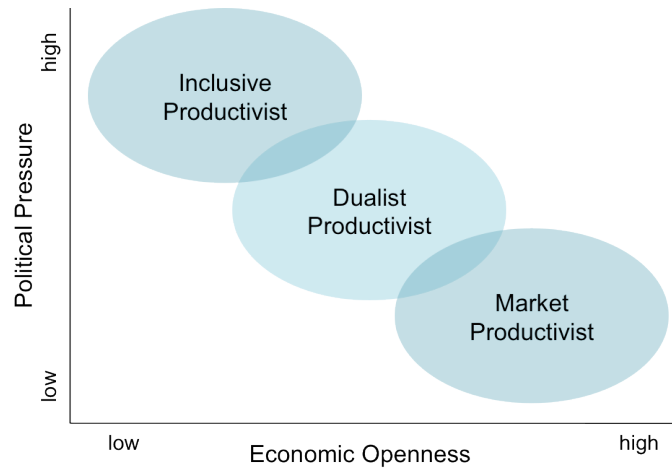
By contrast, inclusive measures of productivist welfare are likely to be prevalent in economies with “market-distorting” practices. In these economies, the government plays a

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<sup>4</sup> Huber and Stephens (2001) also argue that there are “elective affinities” between production regimes and patterns of social protection.

significant role, orchestrating the overall economic development strategy. Firms are operated based on government-linked bank loans and/or foreign borrowings rather than foreign investment. Their loans and borrowings help the government obtain and possess strong policy autonomy, which is required for the protection of domestic industries against foreign competition (Kim 2002, 401). That is, the accumulation of “patient” and “less liquid” capital can make the economies less vulnerable to the interests of foreign shareholders. In this case, the protection of skilled labor of domestic industrial sectors is among the most critical tasks for long-term economic development and, to this end, the government is likely to adopt an *inclusive* risk-pooling system to protect industrial workers. Because social insurance is a contribution-based risk-pooling scheme, inclusive social insurance is cost-effective for the government that aims to protect important human resources from social contingencies while avoiding full financial responsibility (Goodman and Peng 1996, 207).

In short, the degree of economic openness and the corresponding strategies drive the institutional divergence of PWC. Although East Asian NIEs commonly share the productivist code that social policy is an important instrument to promote labor productivity, human capital accumulation, and economic growth, their differences in economic structure and strategy generate different patterns of PWC. Figure 1 illustrates this argument.



**Figure 1.** Three Worlds of Productivist Welfare Capitalism

### 1.2.3 Political Pressure

The analysis of social welfare often focuses on the *supply* side, investigating what kind of welfare programs are provided by policy makers. This is particularly true in the case of East Asia where economic strategies have nurtured the development of productivist welfare. As I have explained above, “market-distorting” and “market-conforming” economies have produced different strategic complementarities, causing different pathways to productivist welfarism. Although this argument is by and large convincing, however, we cannot underestimate the influence of the *demand* side of social policy because, in many cases, the character of social policy is shaped by the interaction between the supply (policy makers) and demand (general public) sides of the political market (Haggard and Kaufman 2008, 13-17).

In general, due to the need to cater to a broad electoral base, democratic regimes are more influenced by the demand side than their authoritarian counterparts. Politicians in democratic regimes often use redistributive social programs as a means of appealing to broader

constituencies in order to win and retain office, so they tend to have a stronger social policy commitment. Indeed, democratic transition in East Asia has generated great political pressure, altering the incentive structure of the ruling parties and also compelling them to shape a new course of productivist social policies. For example, the introduction of democratic electoral competition in Korea, Taiwan, and the Philippines led the ruling parties to adopt or expand social insurance programs (that might have been otherwise eschewed) as a means to gain public support for the regime (Haggard and Kaufman 2008, 221-261).

Regarding the impact of political pressure in democracies, we also need to take into account citizens' political attitudes toward their regime. Generally, democratic transition brings about changes in citizens' expectation of government, leading to the quantitative increase of "critical citizens" (or "dissatisfied democrats") (Norris 1999). Economic growth and democratic transition tend to produce a public that becomes less respectful to authority and more engaged in various contentious actions with a higher expectation of government's role.<sup>5</sup> Several survey data confirm this assumption, reflecting a decline of political trust in democratic IPW states like Japan, Korea, and Taiwan while revealing a higher level of political trust and satisfaction among many nondemocratic MPW states like Singapore and Hong Kong (Ahn and Kang 2002; Inglehart and Welzel 2005; Shin 2001; Tanaka 2001; Tang 2005; Wang 2005).<sup>6</sup> These findings

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<sup>5</sup> Huntington (1968, 41) succinctly points this out, saying: "Modernity breeds stability, but modernization breeds instability."

<sup>6</sup> China, one of the dualist productivist welfare states in this study, shows a very high level of political trust and regime support. But interestingly, the survey results indicate that the perception on the government is substantially fragmented between urban and rural residents. In urban areas, as state-sector workers lost their jobs and welfare benefits that they had enjoyed during the Mao Zedong era, labor protests rose dramatically, underpinning the broken promises of the Chinese Communist Party (CCP). As one of the methods to deal with growing dissatisfaction among urban workers, the Chinese government has developed social policy measures such as new pension and health insurance programs. In rural areas, however, a few of workers and virtually none of farmers have been actively involved in job-related protests. Although the number of peasant collective actions has increased since the 1990s, Chinese farmers demonstrated against corrupt local officials rather than the central leadership (Bernstein and Lu 2000). In other words, rural protests did not constitute a significant threat to the regime. Interestingly, the level of political trust in rural areas is much higher than in urban areas. This fragmented political attitudes between urban

indicate that authoritarian regimes are less vulnerable to political pressure than their democratic counterparts, and accordingly, the latter is likely to attempt to garner political support through expansion of inclusive social policies. That is, different political attitudes of the people produce different impacts on the productivist approach to welfare capitalism.

Of course, *inclusive* welfare benefits are not always provided only in democratic regimes. Authoritarian states often adopt inclusive programs such as pension and health insurance as a winning platform for regime support (Bueno de Mesquita et al. 2003).<sup>7</sup> However, as seen in the cases of authoritarian Korea and Taiwan during the 1960s–1970s, the provision of insurance benefits was highly limited and selective. The benefits were mainly for those who were deemed politically and economically important—especially skilled workers, civil servants, and the military. Their “inclusive” welfare benefits served only a limited number of populations in a “selective” manner, exacerbating social class differences (Peng and Wong 2010, 662). Although the authoritarian regimes with the market-distorting economy used to adopt inclusive measures of PWC for economic and political needs during the earlier period of industrialization, they were less likely to *extend* those programs to the whole population. Because the extension of coverage and entitlement requires greater financial responsibility and political accountability, any significant and meaningful expansion of IPW is unusual in authoritarian developmental states whereas it tends to be positively related with democratic regimes that are more responsive to political pressure and public opinion. In other words, as productivist welfare states become

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and rural residents have led the CCP to apply IPW measures to urban China and MPW measures to rural China, resulting in a dualist strategy of productivist welfarism (Gallagher 2002). I will further examine the development of China’s DPW in Chapter 4.

<sup>7</sup> In their “selectorate” theory, Bueno de Mesquita and his colleagues (2003) argue that authoritarian rulers are also politically sensitive to their constituencies in maintaining power. Just like in their democratic counterparts, the size of the selectorate and the size of the winning coalition are critical to a ruler’s policy output in authoritarian regimes. In short, dictators use some combination of carrots (such as welfare programs) and sticks (coercive and repressive measures) in order to build support or acceptance of the ruler.



democratized, the extension of IPW is accepted as a strategic choice to deal with political pressures of electoral competition and “critical democrats.” In this regard, it would be fair to say that economic conditions (the degree of economic openness) determine the *creation* of institutional variation in PWC while political conditions (the degree of democratic governance) influence the *growth* of the variation.

### 1.3 TERMS, SCOPE, AND METHODS OF ANALYSIS

#### 1.3.1 Terms

It is worth noting at the outset the way I plan to use the terms *social security*, *social protection*, *welfare system*, *welfare state*, and *welfare regime*. Despite numerous definitions of these terms, however, there is no single agreement about what constitutes each term. For example, some argue that the *welfare state* connotes a set of interconnected legal, political, and social rights. For others, it is just convenient shorthand for the many social programs that are found in most states (Overbye 2010, 153). As such, the concepts of these terms are indeed ambiguous and slippery (Gough 2001, 165). This is why I will use these terms somewhat loosely in this research. Nonetheless, a distinction—with less but at least rough accuracy—needs to be drawn to underline selected aspects of them.

First, ILO (1984, 3) defines *social security* as “the safety net that society provides for its members through a series of public measures.” In most cases, this term is used somewhat narrowly in the context of contributory insurance-type or savings-type schemes. As suggested by

the ILO, this study uses the term *social security* as an equivalent for insurance programs or some other formal schemes set up by the government.

Second, *social protection* is defined to include a broader range of public and private measures—not only contributory schemes but also non-contributory programs—designed to “reduce poverty and vulnerability by diminishing peoples exposure to risks and enhancing their capacity to protect themselves against hazard and loss of income” (Ortiz 2001, 41).

Third, the *welfare state* and *welfare system* are often used to indicate a set of institutionalized state measures to meet key welfare needs, often confined to old-age pension, health, unemployment, work injuries, education, housing, public assistance, and social services (Pierson 2007, 10; Wilenski 1975, 6-7). Because *welfare state* and *welfare system* signify institutional aspects of social protection, I will use them interchangeably with *social protection* in this study, especially when I intend to highlight differences and similarities of institutional patterns of PWC.

Lastly, *welfare regime* is defined as a complex of legal and organizational features of social policy that are systematically interwoven to reflect consistent and deep-rooted principles and norms of social well-being (Esping-Andersen 1990, 1-3). That is, *welfare regime* symbolizes principles that are historically developed and embedded in a society, whereas *welfare state* and *welfare system* signify institutional formats on which social policies are designed and implemented to achieve the core principle of *welfare regime*.<sup>8</sup>

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<sup>8</sup> Esping-Andersen (1990: 2, 1999: 73) defines *welfare regime* as a constellation of social, political, and economic “principles” under which welfare production is allocated between state, market, and households. Particularly, *welfare regime* highlights the continuous effects of the historical legacy embedded in relations between the state and economy with respect to production, distribution, and redistribution. Accordingly, *welfare regime* is hardly changed even in the face of internal (e.g., demographic changes) and external (e.g., economic globalization) challenges.

## **1.3.2 Scope**

### **1.3.2.1 Policy Areas in Concern**

This research intends to investigate institutional variation in PWC since productivist welfare states are believed to have undergone institutional changes corresponding to economic and political circumstances. To this end, I examine old-age pension, health, and public assistance among several areas. This relatively narrow focus is due to the need to select some common areas out of a broad range of policy agendas, and which can allow generalization of statutory system of social protection in East Asia. Because pension, health, and public assistance are large policy sectors that together account for a very substantial—if not the largest—share of government expenditures in most countries and therefore are commonly believed as requiring the provision of them, I focus on the institutional forms and effectiveness of these three policy areas.

### **1.3.2.2 Case Selection**

This dissertation is about intra-regional variation in PWC of East Asia. Yet, there may be some confusion over how to define the range of East Asia. The traditional way is to select the so-called “four tiger economies” (Korea, Taiwan, Hong Kong, and Singapore) plus Japan, focusing on economic development and cultural backgrounds (Goodman and Peng 1996, 194-198). Unlike this traditional choice, I use the term East Asia as shorthand for Northeast and Southeast Asia, encompassing 11 states (Japan, Korea, Taiwan, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, Thailand, Vietnam, and China), although the main theoretical ideas of this study came from my special attention to Korea, Singapore, and China.

The extended application of the PWC theory to 11 East Asian states gives us several benefits. Among others, it allows us to combine the advantages of the “most-similar-and-most-

different-systems” approach (Przeworski and Teune 1970). The first five countries have long been regarded as the first generation of the developmental state while the next six countries are viewed as a second generation of developmental states.<sup>9</sup> This generational factor will help control different income levels and different industrialization phases in statistical analysis. And also, two transition economies included in my case selection (i.e., China and Vietnam) would increase case quantity and diversity on the one hand and lessen case selection bias on the other hand.

In addition to their diversity, the selected cases provide a significant similarity in terms of their approach to economic development. All of these countries view economic growth as the supreme policy objective, and as a consequence, social policy has been largely driven by their industrialization strategies. Another similarity is that, in the face of political crises, they have often taken sporadic initiatives in social security provision in order to garner political support from strategic groups among the citizens (Gough 2004, 187). Thus, unlike recent studies that have focused on the limited number of productivist welfare states, this study provides a more comprehensive picture of East Asian PWC.

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<sup>9</sup> A “developmental state” refers to a state that plays a strategic role in economic development with a competent bureaucracy that is given sufficient policy measures to take initiatives and operate effectively. Johnson (1982) is among the first scholars who used the term “developmental state,” followed by Amsden (1989), Wade (1990), and Haggard (1990). Johnson (1982) portrayed Japan as a pioneer model of the developmental state. The very idea of the developmental state fundamentally differed from what is prevalent in the Anglo-American nations. The developmental state was designed through the Meiji Restoration in the 1860s when the modern Japanese nation-state attempted to respond the challenge posed by western capitalist expansion (Cheng 2009, 26). Although the developmental state approach is not a coherent frame of concepts and theories, it is widely used as an analytical tool to underscore East Asia’s development practices.

### 1.3.3 Methods

Analytical methods of this study rely on a combination of statistical analyses and case studies. First, I start out with comparative quantitative analyses to find the determinants of welfare state development in East Asia. The value of this kind of analysis is beyond doubt. In general, the use of aggregated data facilitates the identification of broad patterns and confirms the existence of a causal relation between various factors. Nevertheless, however, many of the East Asian welfare studies are either descriptive or single case-focused, so their conclusion (or generalization) is hardly convincing (Ramesh and Asher 2000, 2). This problem is mainly due to the absence of a systematic cross-sectional time-series data set derived from theoretical perspectives (Ku and Finer 2007, 129). The data problem makes it difficult to discover a true picture of the causal nexus behind the productivist welfare strategy. To overcome the shortcomings of the existing literature, I take a quantitative approach in Chapter 2, in which cluster analysis is used to search for not only underlying subcategories of PWC but also theoretical and empirical sophistication of the current PWC discourse. And then, Chapter 3 employs cross-sectional time-series analysis to measure the impact of explanatory variables—economic openness and political pressure—on institutional variation in PWC.

While the above quantitative approach provides great benefits, the gap between quantitative and qualitative approaches should be addressed (Janoski and Hicks 1994). One of the most obvious problems for statistical analyses is the use of a single value to characterize the welfare state and its divergence. Moreover, any possible inaccuracy of country-level and time-line data makes any findings potentially questionable (Peters 1998). Because of the tremendous heterogeneity that exists among East Asian states, more cases can be not only a plus but also a minus (Haggard and Kaufman 2008, 18). Therefore, despite the potential weaknesses of

qualitative analyses, it is necessary to utilize some advantages of case studies over the statistical research. For this reason, I use in Chapter 4 three cases—Korea’s IPW, Singapore’ MPW, and China’ DPW—to locate my findings in their particular settings. The combination of quantitative and qualitative approaches will provide a deeper understanding of the reality.

#### 1.4 ORGANIZATION OF THE STUDY

Is there systematic variation in PWC? If so, what are the major determinants differentiating the course of welfare development in East Asia? To address these puzzles, this study develops a comparative analytical framework with statistical tests on 11 East Asian states covering the period from the early 1980s to the late 2000s. It is also complemented by detailed case studies of three societies. The rest of the dissertation is organized as follows.

Focusing on the divergence of PWC, Chapter 2 present three models—IPW, MPW, and DPW, elaborating on how two theoretical dimensions, *risk-pooling* and *self-help*, have shaped institutional configurations in East Asia. Cluster analysis is employed to test this argument. Chapter 3 searches for causal patterns, investigating what factors have been driving institutional variation in PWC. It evaluates the existing theories first and then lays out economic and political circumstances under which East Asian productivist welfare states promote either more inclusive or more market-oriented institutions. Particularly, I examine the impact of economic openness and bottom-up political pressure and their interaction. To this end, I conduct cross-sectional time-series analysis. Chapter 4 then presents three case studies—Korea, Singapore, and China—each of which is presumed to be a typical case of IPW, MPW, and DPW, respectively. These cases will show how the productivist pattern of welfare capitalism was introduced and became

diversified. Chapter 5 summarizes my arguments and implications with some suggestions on how further studies can enrich our understanding of East Asian welfare regime.

## **2.0 IS THERE SYSTEMATIC VARIATION IN PRODUCTIVIST WELFARE CAPITALISM IN EAST ASIA?**

### **2.1 INTRODUCTION**

As is often pointed out, aggregate government social expenditures in East Asia are much lower than in most other regions of the world (Haggard and Kaufman 2008; Segura-Ubiergo 2007). If we use government social expenditure as a proxy for welfare state development, East Asia is among the least developed welfare states. What catch our attention, however, are not only the low level of government spending but also the pattern of social policy expenditure. Compared to other advanced capitalist societies where social welfare is the major policy area for public expenditure, East Asian states spend more on human capital formation such as education, focusing on the “productive” function of social policy. Deyo (1992, 289) describes this feature as “developmentally supportive social policy,” arguing that social policy in East Asia is driven by the needs of developmental economic strategies. Goodman and Peng (1996) also assert that in East Asia social policy is dominated by economic rather than social considerations. To conceptualize this unique nature, Holliday (2000) proposes the so-called “productivist welfare capitalism” (PWC), describing how East Asian states use social policy as an important instrument to facilitate economic growth.



Despite the shared nature of “productivism,” however, East Asian states reveal marked differences in their institutional configurations (Kwon 2009; Peng and Wong 2010). Some states enhance the role of social insurance programs to cope with challenges arising from economic globalization and rapid demographic changes (Ku 2003; Kwon 2005). For example, Korea and Taiwan have strengthened national pension and health insurance programs with a steady increase in government expenditures on public assistance. In contrast, some other states have remained largely unchanged, emphasizing the self-help principle inherent to PWC. For instance, Singapore and Malaysia maintain their compulsory individual savings schemes that were adopted in the early stage of industrialization. Savings schemes are quite different from social insurance schemes in terms of that the latter is characterized by risk-sharing and fund-pooling while the former stresses individual responsibility for risks and funds.

This contrast has prompted scholars to cast doubt on the usefulness of a *holistic* approach of the “productivist welfare” thesis (Kim 2008; Wilding 2008). Although a number of scholars still advocate the use of the “productivist” thesis as an analytical cornerstone of East Asian welfare studies, some important questions should be addressed (Ku and Finer 2007). Is there truly systematic variation in PWC in East Asia? If there is empirical evidence of such variation, we have to revisit the existing PWC approach to accommodate various types of productivist welfare states in a more comprehensive theoretical discourse.

The purpose of this chapter is to address these questions by providing theoretical grounds and associated empirical evidence. This chapter is structured as follows. The next section examines the characteristics of PWC, shedding light on the differences between East Asia and the other parts of the world. The third section argues that, despite their productivist nature, East Asia states exhibit different trajectories of welfare institution. More specifically, I hypothesize

that there are three models of PWC—namely, *inclusive productivist welfare* (IPW), *market productivist welfare* (MPW), and *dualist productivist welfare* (DPW). To test this hypothesis, I conduct cluster analysis in the fourth section with the data obtained from 11 East Asian states and then present the findings. Concluding remarks are provided in the last section.

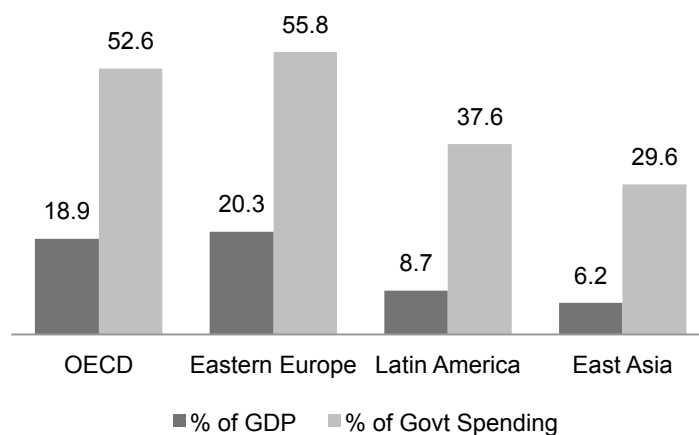
## **2.2 EAST ASIAN WELFARE REGIME FROM A COMPARATIVE PERSPECTIVE**

### **2.2.1 Productivist Welfare Capitalism in East Asia**

Political and economic changes that occurred in the developing world throughout the 1980s and 1990s called scholarly attention to welfare state development in East Asia, Latin America, and Eastern Europe (e.g., Haggard and Kaufman 2008; Huber 1996; Kaufman and Segura-Ubiergo 2001; Segura-Ubiergo 2007). Their interest was largely based on the prevailing view that welfare state development requires industrialization and/or democratization as a necessary condition (Pierson 2007, 9-40). However, despite the remarkable economic development over the past decades, East Asian states have not been among those spending a considerable portion of revenues on social security and welfare. Certainly, East Asia is not impressive in terms of government expenditure on social welfare policies.

As seen in Figure 2, East Asian states have spent much less on social policy as a whole than OECD, Eastern European, and Latin American countries during the 1970s to 2000s. While the average level of social expenditure ranges from 8.7 percent to 18.9 percent of GDP and 37.6 percent to 52.6 percent of total government spending in the other parts of the world, East Asia's

expenditures are only 6.2 percent and 29.6 percent, respectively.<sup>10</sup> Without doubt, East Asian states are among those who spend least for welfare.



**Figure 2.** Average Government Expenditures on Social Security, Health, and Education (the 1970s to the 2000s)

*Note:* (i) Based on average central government expenditures (except China that includes both central and local governments); (ii) Selected countries include 19 OECD states, 6 Eastern European states, 14 Latin American states, and 11 East Asian states; (iii) Data for OECD and Latin America cover the 1973 to 2000 period. (iv) Data for Eastern Europe are from the 1990s only; (v) Data for East Asia include the 1980s to the 2000s.

*Source:* IMF, *Government Finance Statistics*; Asian Development Bank, *Key Indicators*; various national statistical yearbooks; Segura-Ubiergo (2007, 13-14).

But the low level of social spending is not the only attention-grabbing characteristic of East Asian welfare states. Their sector-based statistics also reveal a sharp contrast to those of the other regions. Unlike OECD, Eastern European, and Latin American countries in which social welfare is by far the biggest spending sector, East Asian states spend substantially more on economic development programs (22.7 percent of total government spending) and education (14.9 percent)

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<sup>10</sup> Japan's expenditure on social welfare is as high as about 23 percent of total government expenditure, but it is still low by western European and North American standards.

than on health (5.9 percent) and social security (8.8 percent) (see Table 1). In East Asia, economic development and human capital formation have featured as a leading policy thrust, while welfare benefits have remained marginal.

This contrast has impelled scholars to raise the question of why welfare spending in East Asia is not as significant as in Western Europe, Latin America, and Eastern Europe. Why has human capital formation—reflected in a high priority to the provision of primary/secondary education and vocational training—been central in East Asia?

Earlier studies approached this issue from two perspectives. The first group of scholars emphasized cultural factors, particularly the impact of Confucian values. Dixon and Kim (1985), Jones (1990, 1993), and Rieger and Leibfried (2003) attributed East Asia's low level of welfare expenditure to "familialism" that produced an aversion to public social services. According to them, the Western style of welfare state development would be barely possible in East Asia because Asian countries strongly adhered to the Confucian tradition of patriarchal responsibility for care and protection of the family household. They believed that in East Asia the traditional values of Confucianism would continue to hinder the development of egalitarian welfare states on the one hand and impose a strong emphasis on education on the other.

**Table 1.** Government Expenditure on Social and Economic Policies in East Asia

% of Total Government Expenditure

	Education				Health				Social Security				Economic Affairs			
	80s	90s	00s	Avg.	80s	90s	00s	Avg.	80s	90s	00s	Avg.	80s	90s	00s	Avg.
CHN	11.5	14.9	13.3	13.2	9.7	4.8	3.1	5.9	1.7	2.3	7.9	4.0	53.8	41.0	30.1	41.6
JPN	9.3	15.0	12.4	12.2	13.6	20.6	22.2	18.8	18.8	18.6	23.6	20.3	7.4	8.9	9.3	8.5
KOR	18.5	17.9	14.9	17.1	1.7	1.1	0.8	1.2	7.0	9.6	17.1	11.2	19.3	22.0	21.9	21.1
TWN	5.2	9.2	11.5	8.6	1.6	0.6	1.3	1.1	15.2	22.3	23.8	20.5	16.7	18.4	19.2	18.1
HK	16.4	17.9	20.7	18.3	8.4	11.3	12.4	10.7	5.3	7.4	12.4	8.3	22.3	18.6	18.6	19.8
SNG	17.0	20.3	20.9	19.4	4.8	6.4	6.0	5.7	1.2	3.3	5.8	3.4	16.6	13.4	13.1	14.3
IND	11.7	8.7	4.3	8.2	3.3	2.5	1.4	2.4	.	5.9	6.5	6.2	60.9	22.7	5.7	29.8
MAL	16.7	20.5	23.3	20.2	4.3	5.8	6.8	5.6	4.0	3.7	4.2	3.9	24.7	19.9	18.3	21.0
PHL	12.4	15.6	15.3	14.5	3.7	2.7	1.8	2.7	0.8	2.3	5.0	2.7	27.6	24.0	22.6	24.7
THA	19.6	20.9	21.0	20.5	5.4	7.1	8.3	6.9	3.7	3.5	8.5	5.2	16.0	29.8	20.6	22.1
VTN	.	11.7	12.5	12.1	.	4.2	3.3	3.7	.	12.4	9.0	10.7	.	27.2	29.9	28.6
Avg.	13.8	15.7	15.5	<b>14.9</b>	5.6	6.1	6.1	<b>5.9</b>	6.4	8.3	11.3	<b>8.8</b>	26.5	22.4	19.0	<b>22.7</b>

*Note:* Based on average central government expenditures (except China that includes both central and local governments).

*Source:* IMF, *Government Finance Statistics*; World Bank, *World Development Indicators*; Asian Development Bank, *Key Indicators*; MIAC, *Japan Statistical Yearbook*; National Bureau of Statistics, *Statistical Yearbook of China*; General Statistical Office, *Statistical Yearbook of Vietnam*.

By contrast, the other group examined the role the state played in the process. Most noticeable was Deyo's argument that "East Asia's social welfare is used as a policy tool for economic development." According to him, social policy in East Asia—particularly, Japan, Korea, Taiwan, Hong Kong, and Singapore—is "driven primarily by the requirements and outcomes of economic development policy" (Deyo 1992, 289-290). Since the publication of this view, scholarly works on East Asian welfare states have been greatly influenced by the hallmarks of the "developmental state" thesis. In explaining the characteristics of East Asia's welfare regime, the state-centered approach has highlighted (i) small government expenditures on social welfare,

(ii) social security benefits for selective groups of industrial workers, and (iii) the priority placed on education (Tang 2000).

Holliday (2000) also scrutinized this pattern in his model called “productivist welfare capitalism” (PWC). The PWC model was predicated on the claim that, unlike advanced capitalist societies where social welfare generally embodies the successes of social democratic politics, East Asia’s social policy is strictly subordinate to the overriding policy objective of economic growth. In this regard, the PWC thesis was obviously an extension of the developmental state theory. According to Holliday, Esping-Andersen’s (1990) *Three Worlds of Welfare Capitalism*, which is most widely cited in the field, cannot properly explain the development of East Asian welfare states.<sup>11</sup> It is because the *Three Worlds* typology focused on the degree of *protective* social rights without considering the *productive* function of social protection that is particularly significant in East Asia.<sup>12</sup>

On this note, Holliday asserted that social welfare in East Asia has been mainly determined by productivist principles of (i) minimal social rights with extensions linked to productivist activity, (ii) reinforcement of the position of productive elements (e.g., education and job training) in society, and (iii) state-market-family relationships directed towards growth

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<sup>11</sup> Although there have been debates regarding its validity, Esping-Andersen’s (1990) three ideal types of welfare states—*liberal*, *conservative*, and *social democratic* models—are broadly accepted as the most common approach in the comparative welfare state literature (Arts and Gelissen 2002).

<sup>12</sup> Drawing on Polanyi’s (1944) view, Esping-Andersen argues that the patterns of historical class coalition determined the main features of each welfare model. According to him, the class coalition of the working class and farmers shaped the social democratic model of welfare capitalism in the Nordic countries. He views “social democratic” welfare states as promoting an equality of the highest standards with the principles of universalism. In the continental European countries, political conservatives formed “reactionary” alliances, which led to the “conservative” model of the welfare state. The Anglo-Saxon countries, where the “liberal” model emerged, did not experience a class coalition and as a result only a modest level of welfare benefits became prevalent. Unlike the European case, however, this typology does not fit the reality of East Asia. First, in East Asia, there were no strong capitalists who favored the formation of “liberal” welfare states. Capitalism in East Asia was created in the process of state-led industrialization (Cumings 1984). Second, there was no powerful landlord class promoting the formation of “conservative” welfare states (Kay 2002). Third, East Asia did not have an opportunity of coalition combining the working class and farmers, which might have favored the development of “social democratic” welfare states (Kamimura 2006, 316).

(Holliday 2000, 708).<sup>13</sup> According to him, the core principles of productivist welfarism were derived from East Asia's "growth-first-and-distribution-later" strategy. Others also argued that, with the belief that the government's social welfare spending brings a burden on the economy and consequently undermines international price competitiveness, family welfare and/or occupationally segregated corporate welfare have become a major method of social security provision in East Asia (Song and Hong 2005, 180). As such, Holliday and the advocates of PWC believed that East Asia's economic strategies have led the governments to be avoiding any strong financial commitments to social welfare while expanding investment in education to encourage individuals to participate in the market place and eventually contribute to national economic development. This is why, they believe, universal social security programs could not develop during the high-speed industrialization period from the 1960s to 1980s (Pierson 2004, 11).

### 2.2.2 Continuities and Changes

A growth-oriented state and the subordination of social policy to industrial objectives are the two central aspects of productivist welfare states, and these features have been largely constant across

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<sup>13</sup> In the real world, the *productive* functions of social welfare are observed in counties other than East Asia. It is true that most countries exhibits hybrid forms of the welfare state, combining *protective* and *productive* components with some extent of variation (Arts and Gelissen 2002, 139). During the past few decades, many OECD countries that once provided universal welfare programs have increasingly emphasized the importance of social investment policies to increase economic efficiency. Cerny and Evans (1999) describe this new policy thrust by using the concept of "competition state." Similarly, Jessop (2000) argues that in Western European societies the traditional style of social protection is gradually replaced with the so-called "Schumpeterian Workfare." As such, a combination of *protective* and *productive* elements has been emerging as a new trajectory of the welfare state in the globalization era (Hudson and Kühner 2009). However, these reform efforts do not aim at a fundamental subordination of social policy to economic policy objectives. In this sense, the *productive* nature of East Asian welfare states is a highly peculiar—if not solely unique—characteristic that marks East Asia out from other parts of the world.

East Asian states (Holliday 2000, 709).<sup>14</sup> However, there is a certain pattern of variation *within* the productivist world. If we look at Table 1 carefully, we can find both deep-rooted similarities and newly rising differences at the same time. Without doubt, economy-related affairs and education account for a significant—if not the largest—portion of government expenditure in East Asia. Also, most East Asian countries have begun to increase their expenditures on social security and welfare since the 1990s (Cheung 2009; Lee and Ku 2007). However, the speed and magnitude of the increase vary across the countries.

Some states like China, Singapore, Indonesia, Malaysia, Philippines, and Thailand display an increase of social welfare and health spending, but the overall amount is just slightly over 1% of GDP or much less than 10% of total government spending. In the case of Singapore and Malaysia, reluctance to the expansion of social welfare continues to exist, coupled with rather strong support for public education and vocational training. To date, they remain with a strong resistance to unemployment benefits of any sort and a strictly conditioned system of social assistance (Holliday and Wilding 2003; Ramesh and Asher 2000).

By contrast, some other states like Japan, Korea, and Taiwan have consistently increased government expenditure on social protection. Moreover, throughout the 1980s to the 2000s period, the level of social welfare spending has been considerably higher in these countries, compared to the rest of East Asian states. The development of social welfare measured by non-financial indicators is also impressive. Korea is a good example. Referring to several Japan's social policy programs, Korea has enacted a series of legislation to consolidate the foundation of

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<sup>14</sup> Lee and Ku's (2007) cluster analysis verifies the existence of productivist welfare regime that is distinct from Esping-Andersen's (1990) liberal, conservative, and social democratic types of welfare regime. Rudra (2007) also argues that a "protective" system is one of the three types of welfare states in the developing world. According to her, productive welfare states tend to intervene in markets to increase international market competitiveness and consequently social policies are circumscribed and subject to economic policies. Not surprisingly, all the East Asian samples in her research are identified as "productive" welfare states.



social safety net since the 1997 financial crisis (Hwang 2007; Kwon 2002). When the National Pension Scheme (NPS) was introduced in 1988, it aimed to cover only large-firm employees and skilled workers, but during the 1990s, the NPS was substantially extended to farmers, fishermen, and the self-employed. Korea also implemented an unemployment insurance program in 1995 and has extended the benefits to entire workers in formal sectors during the 1990s and 2000s. Moreover, hundreds of social health insurance programs that had been occupationally segregated became unified in a single and nationwide health insurance program in 2000. In addition, a new social assistance system—the Minimum Living Standard Guarantee (MLSG)—was enacted for those who were in need but not entitled to public assistance under the previous scheme. Taiwan has also been taking similar steps to develop a social security system during the 1990s and the 2000s (Aspalter 2002; Ku 1997).

The recent development of social security in Korea and Taiwan seems to be a significant leap away from the *typical* mode of productivist welfare state. This is why a group of scholars increasingly argue that these countries have been moving from the East Asian *productivist* model to the European *social democratic* model (Kim 2008; Kuhnle 2002; Kwon 2002; Ramesh 2003). However, it is questionable to view the expansion of social protection programs as an indicator of a paradigmatic shift. It is because the development of social protection in Korea, for example, is still based on the productivist credentials.<sup>15</sup> In this sense, it is more appropriate and accurate to see the Korea's welfare expansion as a policy effort, rather than a paradigmatic shift, to mitigate

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<sup>15</sup> The imperatives of Korea's "Productive Welfare" (생산적 복지, saeng-san-jok pok-ji), which was officially proposed by the Kim Young-Sam government (1993-1997) for the first time and built up by the Kim Dae-Jung government (1998-2002), was "state support for a national minimum income floor through job opportunities and training for the poor and disabled" (Song and Hong 2005, 191-192). This principle is largely equivalent to *workfare* aiming at the creation of work incentives for the long-term growth of the economy.

any negative effects caused by the increase of labor market flexibility (Holliday 2005; Kim 2002).

In either way, however, the current single-lensed productivist welfare thesis is not nuanced enough to address the question of why, despite their continuing basic nature of productivist welfarism, some states weave a more inclusive and somewhat redistributive social safety net while some others have not made similar efforts. In order to address this puzzle, we need to refine the existing PWC theory tailored to the dynamism of East Asian productivist welfare states.

## **2.3 INSTITUTIONAL DIVERGENCE OF PRODUCTIVIST WELFARE CAPITALISM**

Variation in East Asia's PWC is neither a collection of temporary changes in single social policies nor a fundamental paradigm shift of welfare regime. It is rather a systematic *institutional adjustment* of productivist welfarism corresponding to changes in economic and political circumstances. Based upon this assumption, this section presents a theoretical discussion of how the variation can be understood and measured. The first part introduces two conceptual parameters—redistribution (risk-pooling) and market-efficiency (self-reliance). The second part discusses how to use these parameters to measure the institutional variation in productivist welfarism. The last part presents three models of PWC—i.e., *inclusive*, *market*, and *dualist*.

### 2.3.1 Conceptual Dimensions of Divergence

Regarding the theoretical parameters that presumably drive the institutional divergence of PWC, we can take into account sets of two rivaling political economic thoughts—equality vs. efficiency, redistribution vs. growth, compromise vs. freedom, compensation vs. competition, and protectiveness vs. productivity. All these concepts are frequently referred to as sets of policy doctrines that have long dominated many social policy issues in European industrial democracies (Garrett and Mitchell 2001). Indeed, these two competing camps of political economic thought have produced a lot of debate among policy makers and scholars over the last decades.

*Protective* types of welfare provision were taken for granted as basic social rights during the 1960s and 1970s when prosperity, equality, and full employment appeared to be in perfect harmony in the West (Esping-Andersen 1990). However, alongside the increasing integration of international markets, economic efficiency that used to be a secondary concern has emerged as one of the top agenda since the early 1980s. Because generous welfare benefits were thought to bring about an increase in non-wage labor costs and government budget deficits and ultimately endanger market competitiveness, pressures to cut down welfare programs became intense (Cerny and Evans 1999; Mishra 1999). Subsequent welfare reforms aiming at improving market efficiency have adversely affected traditional social services and redistributive fiscal policies. Although political costs associated with electoral competition constrained welfare retrenchment (Pierson 2001), there is no doubt that *protective* welfare has faced serious challenges from the sheer weight of market competition and efficiency.

Policy concern over a strategic direction toward either *redistribution* or *market efficiency* is not limited to Western “protective” welfare states. East Asian “productive” welfare states have also faced similar challenges as they are more integrated into the global market. Although

economic growth is almost always the most important policy priority for them, East Asian states have not converged into the same form of productivist welfarism.<sup>16</sup> They have opted to develop either more *redistributive* (risk-pooling) or more *market-oriented* (self-reliance) social protection strategies in accordance to their political and economic circumstances. Although *redistribution* itself is not the most critical element to them, some East Asian states have adopted inclusive and redistributive measures as a policy tool to foster long-term economic development. By contrast, some others continue to practice anti-redistributive measures for the same economic goal.<sup>17</sup> In this sense, it would be fair to use *redistribution* and *market-efficiency* as a set of conceptual dimensions to measure the degree of divergence of PWC.

First, *redistribution* indicates the process that a common reserve of resources contributed by individuals is provided to the members according to agreed rules (Ortiz 2001, 167). Obviously, this concept is associated with “income transfers” and “risk-pooling.” Focusing on this characteristic, I use the term *redistribution* as a concept that portrays all the government’s policy efforts to promote risk-pooling in hopes for continued economic growth. In other words, *redistribution* in the productivist context is understood as *risk-pooling* that aims to protect strategically important populations—such as skilled workers—from possible social risks.<sup>18</sup>

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<sup>16</sup> In his PWC thesis, Holliday (2000) actually distinguishes three types of PWC—namely, “facilitative,” “development-universalist,” and “developmental-particularist.” According to him, the three subgroups differ in the state-market-family relationship, although all three place social policy subordinate to economic policy. In the “facilitative” type (e.g., Hong Kong), the role of market is prioritized. In the “developmental-universalist” type (e.g., Japan, Korea, and Taiwan), the state underpins market and families with some universal programs. In the “developmental-particularist” type (e.g., Singapore), the state directs social welfare activities of families. However, although he recognizes the existence of various patterns, he does not provide a detailed explanation about why and how these three different types emerge and develop.

<sup>17</sup> Refer to, for example, the Korean, Singaporean, and Chinese cases described in the previous section. Detailed explanations about their different approaches to productivist welfarism will be provided in Chapter 4.

<sup>18</sup> The most widely accepted explanation of redistributive compensation is Ruggie’s (1982) notion of embedded liberalism. According to him, governments attempt to neutralize the negative effects of economic openness by increasing spending on social welfare (Rodrik 1998; Ruggie 1982). Cameron (1978) and Katzenstein (1985) also emphasize the positive relationship between economic openness and welfare state efforts. But they argue that this relationship is not because the government chooses to compensate market losers but because economic liberalization

Redistributive measures are therefore conceived not as a *progressive* development of social rights but as a *strategic* choice coupled with economic considerations.

Second, *market-efficiency* is a concept that describes the extent to which governments stress an individual's responsibility for his/her social security. Generally, as market competition intensifies, states become more concerned with containing upward pressures on domestic costs generated by large public sectors and redistributive tax systems. So an increase in government spending on social protection is often believed to distort labor markets, depress investment, and eventually erode the market competitiveness (Clayton and Pontusson 1998; Pfaller, et al. 1991; Teeple 1995). This concern is particularly significant in those states with a strong commitment to free trade and free market. This is why economic globalization is often alleged to restrict states' fiscal policy autonomy.<sup>19</sup> In the productivist welfare context, the conceptual dimension of market-efficiency is used synonymously with *self-reliance* that underscores anti-redistributive welfare schemes of any sort.

### 2.3.2 Measurement of Divergence

If productivist institutions evolve alongside (i) *redistribution* through *risk-pooling* and (ii) *market-efficiency* through *self-reliance*, what measures can we use to gauge the extent of

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creates strong social democratic forces. Segura-Ubiergo (2007, 8-9) summarizes the redistributive compensation thesis in his book, saying "growing exposure to international markets increases economic insecurity and inequality... As a result, vulnerable economic actor—e.g. those who have lost their jobs or work in industries that cannot face up to the challenges of international competition—will use political channels such as trade unions and political parties to press the governments for compensation... Governments will respond to these pressures by expanding the welfare state to protect the domestic economy, control political unrest, and put into place programs designed to raise the skills of the labor force and make it more competitive in international markets."

<sup>19</sup> However, empirical evidence from OECD and less developed countries is not always supportive of the zero-sum relationship between welfare expansion and market competition. Many studies show that it is rather mixed (Garrett 1998; Garrett and Mitchell 2001; Iversen and Cusack 2000; Kaufman and Segura-Ubiergo 2001; Rudra 2002; Swank 2002).

institutional changes? Many studies use government spending frequently and sometimes solely as a “consistent” and “comparative” measure of welfare effort. It is because data of government spending on social welfare is easily available and also useful for a clear comparison. However, any exclusive use of expenditure data as a proxy of the welfare state causes critical problems. Without doubt, it cannot grasp non-financial “functional equivalents” that reallocate and redistribute resources with a welfare-enhancing goal (Ebbinghaus and Manow 2001, 10). Also, the government expenditure approach is implicitly predicated on the assumption that the resource of social protection is the government account only (Allan and Scruggs 2004, 497-498; Esping-Andersen 1990, 19; Kwon 1998, 29-32).

The establishment of social protection is not only a matter of how much to spend but also an issue of how to design institutional formats. Indeed, a number of less developed countries frequently use less resource-intensive methods for their social security systems (Rudra 2007, 386). Challenging the *orthodoxy* of welfare state studies, Estevez-Abe (2008, 4) suggests scrutinizing the role of institutional configurations and the impact of “functional equivalents” such as active labor market policies. She argues that, “we cannot understand the real scope and full nature of social protection in a country unless we look at the way different policy tools are combined.” Skocpol (1987, 1) also points to institutional aspects such as “the full arrays of programs,” “the expansion of benefits and population coverage for each type of social protection program,” and “the integration of such programs with universally available public assistance for low-income citizens.” As such, we need to search for indicators not only to measure expenditures but also to examine the institutional development of productivist welfare states. By doing so, we will be able to understand the essential features of PWC and their institutional divergence.

What indicators then can be used to monitor institutional aspects of productivist welfarism? The finding of adequate indicators requires the understanding of social policy areas in the first place. In general, social protection includes five broad areas—i.e., old age, health, unemployment, work injuries, and poverty. To deal with these social contingencies, governments provide statutory social security for the general public, using one or more of the following financial resources: (i) government’s general revenues; (ii) mandatory social security premiums contributed by employers and/or employees; and (iii) voluntary contributions to social security funds by employers and/or employees (Ramesh and Asher 2000, 34-38).

As seen in Table 2, institutional platforms of social protection can be distinguished on the basis of “what to fund” and “how to fund.” First, social protection programs financed entirely by the government take two forms—i.e., *public assistance* and *social allowance*. Second, those schemes financed by mandatory contributions from employers and/or employees manifest in the form of either *social insurance* or *individual savings* (also known as Provident Fund). Lastly, voluntary schemes financed from employers and/or employees are often backed by tax concessions. Because this study is interested in examining how the government constructs productivist social security system, I will exclude the third resource (voluntary programs) while focusing on the first (government spending) and second (mandatory contributions by employers and employees) patterns.<sup>20</sup>

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<sup>20</sup> Voluntary social security programs are used in recent years as a way of providing additional benefits to those with higher income. The schemes can be organized in a number of ways, for instance, private insurance, industry-based funds, and contractual savings through financial institutions. Because voluntary schemes are not intended to share social risks, they have little “inter-class redistribution” effect.

**Table 2.** Types and Functions of Social Protection Schemes

	<b>Government-financed Schemes</b>		<b>Compulsory Contributory Schemes</b>		<b>Voluntary Contributory Schemes</b>	
Type	Public Assistance	Social Allowance	Social Insurance	Individual Savings (Provident Funds)	Private Insurance	Contractual Savings
Purpose	Poverty relief	Social compensation	Health & income maintenance (old age, unemployment, work injuries)	Health & income maintenance (old age, unemployment, work injuries)	Health & income maintenance (old age, unemployment, work injuries)	Health & income maintenance (old age, unemployment, work injuries)
Eligibility	Low income households (means-tested)	Universal for all who meet criteria (old age, disability, pregnancy, etc.)	Contributors (non-means-tested)	Contributors (non-means-tested)	Contributors (non-means-tested)	Contributors (non-means-tested)
Funding	Tax revenue	Tax revenue	Insurance premiums (fixed) & tax revenue	Individual savings premiums (fixed)	Insurance premiums (unfixed)	Individual savings (unfixed)
Benefits	Flat-rates	Flat-rates	DB (Contribution & earning-related)	DC (Contribution & interest returns)	DC (Contribution & interest returns)	DC (Contribution & interest returns)
Govt Role	Regulation, Operation, Funding	Regulation, Operation, Funding	Regulation, Operation, Partial funding	Regulation, Operation	Tax concessions	Tax concessions
Risk Prevention	High	High	High	Medium	Depending on premiums	Depending on savings
Risk-Pooling	Limited	Broad	Broad	No	Limited	No
Redistribution	High	High	High	No	No	No

*Note:* Adapted partly from Jacobs (1998, 12); Ku (2009, 145); and Ramesh and Asher (2000, 34-38).

### 2.3.2.1 Government-financed Schemes

Public assistance is a government-financed means-tested arrangement to relieve poverty and economic hardship of individuals and families who earn less than specified income. In general, it is financed entirely from general revenues. Yet, benefits are available only to those who need it and, in many cases, come with a condition that recipients should participate in job training



programs. Social allowance is another type of government-financed scheme, but it is offered to those who meet specific criteria—demographic, social, or health—regardless of beneficiaries' income level. Both public assistance and social allowance is basically redistributive because they are funded through tax revenues. However, public assistance is less comprehensive in terms of risk-pooling, compared to social allowance programs whose benefits are usually universal. Although these government-financed schemes are relatively simple arrangements to administer, it is difficult to use them as a primary social security scheme due to their expensive costs. This is why most states use them as a supplementary method.

#### **2.3.2.2 Compulsory Contributory Schemes**

The second form of public social security institution includes contribution-based schemes such as social insurance and individual savings (or Provident Funds).<sup>21</sup> As a method to cope with several major social risks such as retirement, health, unemployment, and work injuries, many states actively engage in establishing, regulating, and operating either or both social insurance and individual savings programs. What is attractive to the government is that, in operating these schemes, the government does not need to take the first-hand financial responsibility. Social insurance and individual savings schemes rely mainly on financial contributions made by employers and employees. Due to this financial advantage on the part of the government, social insurance and individual savings schemes are widely used as an institutional backbone of social security. Despite their common features, however, compulsory social insurance and mandatory individual savings reveal critical differences. It should be noted among others that social

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<sup>21</sup> See Holzman et al. (2000) and Tang (2000, 9) for further information about similarities and differences between compulsory social insurance and mandatory individual savings.

insurance is a defined-benefits (DB) arrangement whereas individual savings is a defined-contribution (DC) plan.

A DB system specifies the form and level of benefits that the covered population is entitled to receive. It is an insurance plan by nature because, in DB system, contributions made by employees and their employers are pooled into a reserve and then paid to the members when social contingencies such as retirement, illness, and unemployment happen. Participation in risk-pooling is mandatory for all workers meeting certain conditions, and the benefits are typically earning-related and relatively advantageous to the lower income class. This is why social insurance is regarded as a redistributive plan. The redistributive effect occurs not only among contributors of the same generation but also across generations, since insurance plans are usually funded on the pay-as-you-go (PAYG) basis. Certainly, social insurance is an attractive option to the government. It enables the government to provide social security benefits to the working population over the lifecycle, making the contributors share risks and funds among themselves.

However, this does not mean that the government is entirely free from funding the insurance schemes. Because insurers receive different amounts of benefits depending on their income level, deficits in social insurance funds are always possible and, in such a case, the government is supposed to make up the deficits. This is why, although social insurance is earning-related and therefore politically popular, any drastic expansion of insurance programs can result in the substantial increase in government expenditures. Due to this aspect, productivist welfare states in East Asia used to provide insurance benefits *selectively* during the industrialization period. That is, the major beneficiaries of social insurance programs were mostly those who are employed in the formal sector and so can afford to contribute to the funds. This selective access was presumed to mainly protect skilled workers who were considered

important for economic development. As a result, social protection via social insurance programs in East Asia often reinforced socioeconomic inequalities ironically, leaving the vulnerable section of the population outside the welfare system (Kwon 2005, 2). This notion suggests that, although social insurance schemes are *redistributive* by nature, they can be used as a strategic tool of “productive” economic plans rather than “protective” social rights, depending on whether the program is intended to cover the whole population regardless of job type.

The other contributory scheme is an individual savings plan that is essentially a DC system. Under this savings system, employers and employees are required to contribute a fixed portion of the wages to an individual account opened for each employee, and the accumulated savings are centrally managed by the government. Benefit levels are determined according to the total sum of the contributions and investment earnings in the account. The savings are usually available for withdrawal upon reaching the retirement age or for other specified purposes like housing, education, and health. The individual savings scheme is by definition fully-funded, which means the scheme has neither risk-sharing nor fund-pooling and therefore individuals receive only what is accumulated in their account.

Because funds are accumulated separately, the scheme allows neither deficit nor the government’s financial responsibility. Moreover, due to its self-reliance nature, the DC system is believed not to distort labor incentives while the savings boost national capital markets. This is why international economic organizations and mainstream economists advocate individual savings schemes (World Bank 1994). The downside, however, is that it provides little or virtually zero protection to those who do not have income enough to save during working life. In other words, savings schemes have no way to protect those who are really in need. Nonetheless, some East Asian productivist welfare states adopt this compulsory savings scheme as their basic

institutional platform of national social security (e.g., Singapore's Central Provident Fund (CPF), Malaysia's Employee Provident Fund (EPF), and Hong Kong's Mandatory Provident Fund (MPF)).

### **2.3.2.3 Sets of Institutional Selection**

Of course, there is no single optimal scheme that can address all types of social risks or is exactly appropriate for all countries. Because each scheme has its own strengths and weaknesses, most countries develop their own social protection system, combining more than two schemes.<sup>22</sup> East Asian states are not exceptions. They have also sought a combination of several funding types to construct a national social security net.

First, all of the states develop certain types of government-funded program, though the level of benefits varies from state to state. Second, yet more importantly, their efforts to construct a system are largely unfold in three directions: (i) national social insurance plans (based on *risk-pooling*); (ii) compulsory individual savings schemes (based on *self-help*); and (iii) a combination of both (based on a *dualist* strategy). For example, Japan, Korea, Taiwan, and Philippines develop the first direction, whereas Hong Kong, Singapore, and Malaysia are identified as the second direction. Meanwhile, China, Thailand, and Indonesia pursue the third one. Table 3 shows sets of institutional selection pursued by East Asian productivist welfare states.

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<sup>22</sup> Recognizing the limitations of these institutional arrangements, the World Bank (1994) proposes a multi-tiered system that contains three pillars: (i) a state-financed pillar for redistribution; (ii) a mandatory and fully-funded DC pillar for savings; and (iii) a voluntary and supplemental pillar for those who want to save more.

**Table 3.** Institutional Selection of Social Protection in East Asia

	Old Age	Health	Unemployment	Work Injury	Poverty
Japan	Social insurance & Allowance	Social insurance	Social insurance	Social insurance	Public assistance
Korea	Social insurance & Allowance	Social insurance	Social insurance	Social insurance	Public assistance
Taiwan	Social insurance & Allowance	Social insurance	Social insurance	Social insurance	Public assistance
China	Social insurance & Individual savings	Social insurance & Individual savings	Social insurance	Social insurance & Employer liability	Public assistance
Hong Kong	Individual savings & Allowance	Public assistance*	Public assistance*	Employer liability	Public assistance
Singapore	Individual savings	Individual savings	n/a	Employer liability	Public assistance
Thailand	Social insurance & Individual savings	Social insurance	Social insurance	Employer liability	Public assistance
Malaysia	Individual savings	Individual savings	n/a	Employer liability	Public assistance
Indonesia	Individual savings	Social insurance	n/a	Social insurance	Public assistance
Philippines	Social insurance	Social insurance	n/a	Social insurance	Public assistance

Source: U.S. Social Security Administration, *Social Security Programs throughout the World* (<http://www.ssa.gov/policy/docs/progdesc/ssptw/index.html>).

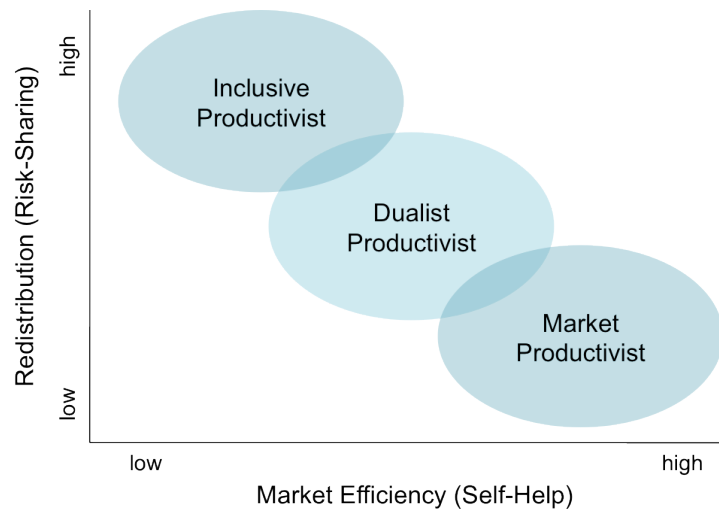
Note: \* The Hong Kong government provides limited public assistance for uninsured citizens.

### 2.3.3 Three Models

The above discussion has considered institutional schemes, focusing on *redistribution* (risk-pooling) and *market-efficiency* (self-help). Based on these two dimensions, I present three models of PWC (See Figure 3).<sup>23</sup>

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<sup>23</sup> Kwon (2005) categorizes the East Asian welfare regime into two types—“inclusive” and “selective”—depending on whether the coverage of social insurance is universal or selective. This dichotomy, however, cannot shed light on the productivist nature of East Asian welfare states. In his analysis, “selective” and “inclusive” welfare regimes indicate the Bismarckian welfare model and the Scandinavian universal welfare model, respectively. Simply



**Figure 3.** Three Models of the Productivist Welfare State

The first is what I call the *inclusive productivist welfare* (IPW) model, one wherein risk-pooling such as social insurance and public assistance are employed as a major policy tool to create an environment conducive to economic development. In Western capitalist societies, redistributive welfare programs are generally understood as an outcome of political mobilization of leftist parties and trade unions to protect those who are placed in a vulnerable position in the economy (Katzenstein 1985; Garret 2000). Yet, in the productivist context, the primary goal of *redistribution* is the promotion of economic development, and such a doctrine comes into play mainly through risk pooling among those who are entitled to participate in social insurance programs.

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speaking, his approach implies that East Asian welfare states evolve into either Bismarckian or Scandinavian models. However, these Western models are not appropriate for the analysis regarding the call for nation-building and economic development that has significantly influenced the East Asian productivist model since World War II. Because productivist welfarism owes its origins to this historical and developmental background, Kwon's typology may oversimplify the pattern of East Asia's welfare state development.

In East Asia, redistributive benefits used to be provided selectively to state employees and industrial workers who were supposed to play a key role in the economy. This is particularly true in the case of Japan, Korea, and Taiwan where the spectacular economic success was attributed to direct state interventions such as economic development plans, total control over the banking system, state-led investment in heavy and chemical industries, and the powerful economic bureaucracy during the industrialization period. In this type of the economy, the protection of skilled labor is an important task. Hence, the lion's share of risk-pooling and redistributive insurance benefits went to middle/upper-income groups, leaving a large portion of the vulnerable population outside the social protection system.

However, as entering the post-industrial period, the economy becomes more diversified with the growth of service sector and, as a result, the protection of unskilled labor also emerges as a new policy agenda. In this new environment, productivist welfare states with redistributive strategies are placed under pressure to broaden the population coverage of the existing social insurance programs by extending to those who would have otherwise been excluded from the benefits. Although the existing risk-sharing system becomes more inclusive, however, this move does not indicate a fundamental shift toward the "social democratic" type of welfare capitalism, because the very essence of IPW is still in tune with economic growth. Nonetheless, it is true that the expansion of social insurance schemes tends to trigger an increase in government spending.

The second type is what I call the *market productivist welfare* (MPW) model, which aims to construct a social safety net through savings-based arrangements. Just like its *inclusive* counterpart, the MPW model uses social policy as a tool for economic development. But the difference is that, while the IPW system underscores positive effects of risk-sharing on economic

growth, the MPW approach has a pessimistic view about any redistributive programs because these are believed to raise production costs and consequently undermine market-efficiency.

However, this does not mean that the market-oriented approach downplays or denies the need of social protection. Recognizing the need and importance of a national social security system, MPW policy makers build up a compulsory savings arrangement (i.e., Provident Funds) instead of inclusive social insurance programs, which is attractive as a vehicle to meet the need of a nationwide social safety net at no cost on the part of the government. Since benefits are linked entirely to contributions in savings-based schemes, there is no deficit problem and therefore the government has few financial responsibilities for citizens' social security. In this MPW model, social protection is equivalent to the sum of compulsory individual savings that is part of the government's efforts to address social risks that render economic growth unsustainable.

Due to its market-oriented nature, this model is more likely to be adopted in open economies—such as Singapore and Hong Kong—that are highly dependent on exports and foreign capital. Without doubt, these open economies are greatly attentive to the interest of foreign investors and hence one of the most important policy tasks is to create an economic environment favorable for foreign investment. For this reason, a savings-based institutional format is appealing enough to meet the dual demands: (i) the attraction of foreign capital and (ii) the construction of social safety net. However, again, the downside is that the MPW model provides little protection to low-income households that cannot save sufficiently during working life.

The last type is what I called the “dualist” productivist welfare (DPW) model that combines IPW and MPW. Unlike the countries that center on either national social insurance or



mandatory individual savings schemes, the dualist model pursues a combination of both.<sup>24</sup> This approach is believed to be an optimal strategy for economic growth, particularly in countries that have a large gap between manufacturing and agricultural sectors or between urban and rural areas. The DPW states tend to install “market-oriented” measures for less productive sectors while setting out “inclusive” programs to protect industrial workers. As such, the most prominent feature of DPW is institutional fragmentation of social security system.

The institutional fragmentation occurs at two levels. The first level of fragmentation is the formal-informal divide. While employees in the formal sector are usually entitled to participate in unified and relatively comprehensive social insurance programs, workers in the informal sector are often provided only with individual savings plans for their social security. The second level is the urban-rural divide. Social insurance programs are usually arranged for urban residents whereas rural dwellers have limited options such as individual savings or family support. In short, the DPW states provide IPW benefits to the formal and/or urban areas and MPW measures to the informal and/or rural areas.

## 2.4 EMPIRICAL TEST: CLUSTER ANALYSIS

In the previous section, I have explored three models of the productivist welfare state—i.e., *inclusive* (IPW), *market* (MPW), and *dualist* (DPW), focusing on two conceptual dimensions of redistribution (risk-pooling) and market efficiency (self-help). I have also examined how social

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<sup>24</sup> Japan’s social insurance programs have a multi-tiered structure, consisting of both pooling and savings components (Tajika 2002). However, the contributory saving portion is not mandatory but voluntary, which means that the government does not play a first-hand role in enhancing saving-based social security. Hence I do not label this type of multi-tiered scheme a “dualist” productivist welfare system.

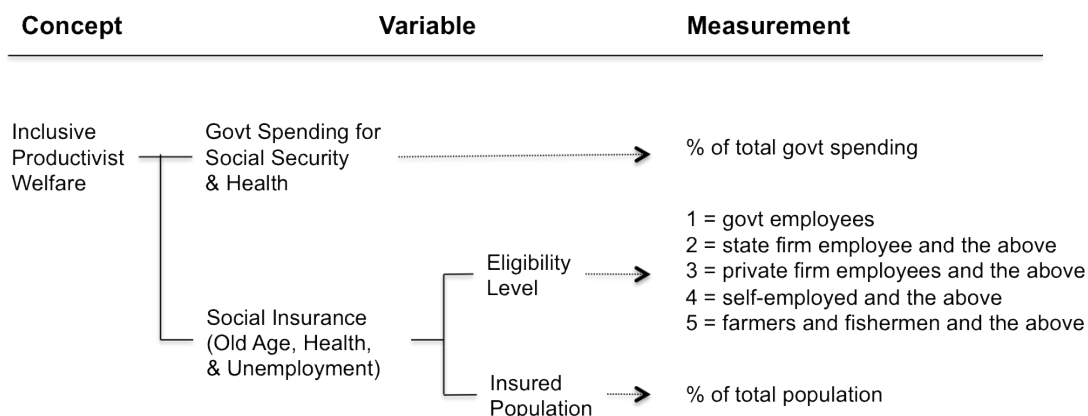
insurance schemes and individual savings schemes provide basic institutional platforms for the three models. Is this imaginative three-model typology empirically compelling enough to convince us that there is a systematic divergence in PWC? This section conducts cluster analysis to test this three-model approach.

### 2.4.1 Variables

The goal of this research is to demonstrate that different types of PWC exist and that they are systematically interrelated. Because there is no single variable to measure the level of “inclusiveness” and “market-orientation” of the productivist welfare state, I develop indices for IPW and MPW using multiple indicators as followings.

First, the IPW index is derived from two factors: (i) the growth of social insurance programs and (ii) government spending on social security and health. The former is to estimate the level of “inclusiveness” of social insurance programs, especially in the areas of old age, health, and unemployment. These policy areas have important sociopolitical implications regarding how the government institutionalizes who gets what and who pays the cost (Hwang 2007, 133).

Instead of considering social insurance programs as a dummy variable, this research codes them as a continuous variable in order to trace the growth rate. More specifically, I measure the percent of insured population and the level of eligibility for insurance benefits (See Figure 4). While *eligibility* is to assess the institutional design of social insurance programs, *population coverage* is to investigate the effectiveness of policy implementation (Adam et al. 2002, 44).



**Figure 4.** Variables to Estimate “Inclusive” Productivist Welfare

If a social insurance program is designed to benefit a selective group of population only (e.g., state employees, military personnel, or formal-sector workers), it will have a limited effect of risk-sharing and redistribution. For this reason, I give “1” if an insurance plan covers only government employees. “2” is given if the plan covers government employees and state firm employees. If the plan provides benefits to private sector employees as well, “3” is given. In this way, I give “4” to a scheme if it covers the self-employed too. Lastly, I give “5” to the most comprehensive system that covers the whole population including the informal sector (i.e., farmers and fishermen). In addition to this eligibility level, the IPW index involves the population coverage rate. Because social insurance schemes can be adopted just in name for political reasons, I measure population coverage rates as well to see the effectiveness of policy implementation.<sup>25</sup>

<sup>25</sup> I have rescaled all variables into 0-10 in the analysis to create an IPW index. For example, 100% of population coverage is equal to 10 in the new scale. Level 5 of eligibility is equal to 10 in the new scale.

Meanwhile, the second factor—government spending for social security and health—enables us to examine what institutional efforts the government makes to reduce poverty.<sup>26</sup> In general, public assistance and social allowance programs require government funding and administering, so it is fair to use government spending as an indicator to measure the level of risk-sharing and redistribution.<sup>27</sup> As such, government spending for social security and health and the growth of social insurance schemes are used in creating an index of “inclusive” productivist welfare states.

Similarly, the MPW index is retrieved from two factors: (i) the growth of individual savings schemes and (ii) private health expenditure. First, individual savings schemes, again, refer to a system wherein all employees and their employers are required to make a contribution to employees’ individual account for retirement benefits and medical expenses.<sup>28</sup> Savings-based schemes are closely related to the government’s institutional effort to alleviate social uncertainties while avoiding direct financial responsibilities.

To measure the significance of the system, this study uses the rate of *population coverage* and the level of *eligibility* for the participation (just as I have done for the IPW index). The former is to see the effectiveness of policy implementation while the latter is to assess the institutional intention of the scheme. If the scheme is designed to cover not only formal-sector workers but also informal-sector workers and even farmers and fishermen, it is not unfair to say

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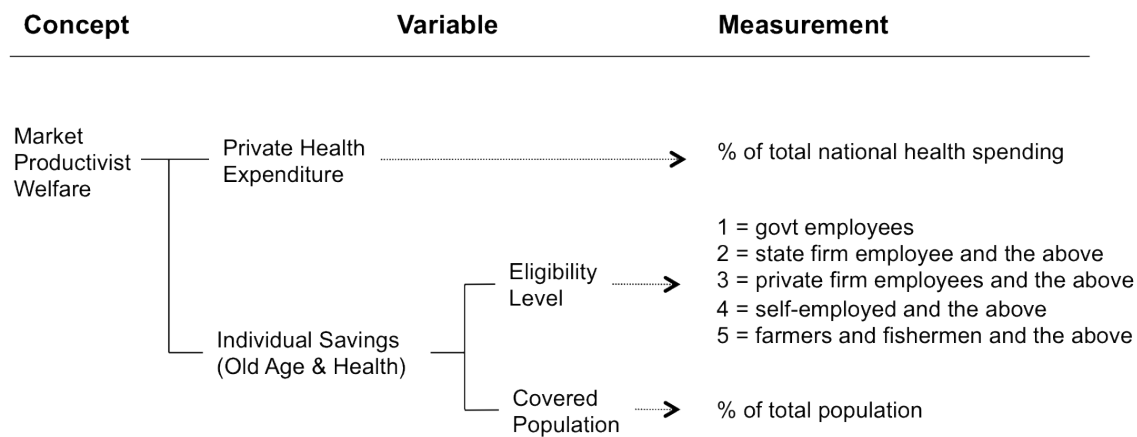
<sup>26</sup> In this analysis, I use government spending measured as a percent of the total government expenditure instead of a percent of GDP, because the purpose of this study is to evaluate institutional aspects of the government’s welfare efforts. This approach has been widely adopted (e.g., Allan and Scruggs (2004, 497-498); Esping-Andersen (1990, 19); Estevez-Abe (2008, 3); Kwon (1998; 29-32); Rudra (2008, 92)).

<sup>27</sup> As Segura-Ubiergo (2008, 134) points out, an important shortcoming of social spending data is that many resources often capture central government expenditure only. This is a critical problem in countries where the degree of fiscal decentralization is high. Therefore, this study uses expenditure data encompassing both the central government and all other levels of local governments.

<sup>28</sup> In Singapore, provident fund accounts of eligible individuals can also be used for higher education and asset-building purpose like house purchase, mortgage payment, or investment (Low and Aw 2004).

that the government has a stronger will to construct a nationwide social security system base on the self-help principle (See Figure 5).

Second, the MPW index includes the percent of private health expenditure as a vehicle to measure the level of “self-help.” Because it is the sum of outlays for health by direct household out-of-pocket payments, it is reasonable to expect that productivist welfare states with a high level of pro-market orientation will have a greater percent of private health spending.<sup>29</sup>



**Figure 5.** Variables to Estimate “Market” Productivist Welfare

## 2.4.2 Analytical Method

An analytical method I employ to test the three types of the productivist welfare state is cluster analysis—a multivariate statistical method that reduces the number of cases by grouping

<sup>29</sup> <http://www.who.int/whosis/indicators/compendium/2008/3exo/en/index.html>.

internally homogeneous cases.<sup>30</sup> Its quantitative estimation of similarity is derived from the distance between observed cases in a coordinate space based on a set of variables. In this analysis, productivist welfare states within the same cluster are expected to be more similar to each other than to other cases within another cluster across all their “inclusive” or “market-oriented” characteristics. Among many different families of clustering methods, this study employs Aldenderfer and Blashfield’s (1984) hierarchical agglomerative method that searches for  $N \times N$  similarity matrix and sequentially merges the most similar cases.<sup>31</sup> This method starts out with individual cases forming multiple clusters and then put similar cases together to identify clusters of relatively homogeneous cases until all cases converge together into one group. Because the hierarchical agglomerative method provides a tree diagram—often called a dendrogram—in which the sequence of mergers of clusters is illustrated visually, we can intuitively understand which cases belong to which categories.

Within the hierarchical agglomerative method, there are several ways to measure the distance between cases—i.e. single linkage, complete linkage, average linkage, weighted-average linkage, and Ward’s method. Among these linkages, I use Ward’s method and the weighted-average linkage. Ward’s method is most widely used, but it is relatively susceptible to the influence of outliers. To control this influence, I use the weighted-average linkage that gives equal weighting to each group no matter how many cases are in each group (Rudra 2008, 102). This study presents the result of Ward’s method because there is no big difference in the outcomes between the two methods.

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<sup>30</sup> For this analytical method, I benchmarked Rudra’s (2008) cluster analysis.

<sup>31</sup> There are two basic approaches to hierarchical cluster analysis—agglomerative and divisive. While the former integrates smaller clusters into larger clusters, the latter splits larger clusters into smaller clusters.

With regard to the coding of variables, cluster analysis calls for the standardization of the values of indicators. It is because cluster analysis is based on a geometric interpretation of the relationship between cases. I have set each variable to values ranging from 0 to 100 to meet this requirement and then computed by the Euclidean metric to figure out how close the cases are located from one another. As such, the distances between cases in the dendrogram will show us whether there are distinct subgroups within the productivist world of welfare capitalism in East Asia.

### **2.4.3 Unit of Analysis and Data**

The unit of analysis is the *national half-decade*. The cases examined include 11 countries across East Asia—i.e., Japan, Korea, Taiwan, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, Thailand, Vietnam, and China. Despite a common belief that economic development is the supreme policy objective, they are different in several aspects. The first five countries have long been regarded as developmental states, and the following six countries are viewed as a second generation of developmental states. The cases include not only high-income and low-income countries but also transition economies like China and Vietnam. Unlike recent studies that have focused on Northeast Asian newly industrialized economies, this study includes Southeast Asian low-income countries and transition economies, and this inclusion will enable us to see a more comprehensive picture of productivist welfare capitalism.

The temporal unit of analysis used here is half-decade. Most prior studies employing cluster analysis have used one particular single year or the average of a certain time period without looking into temporal changes. These cross-sectional studies are static and provide only rough estimates of a given moment. To overcome this shortcoming, I include four time periods

in the cluster analysis (i.e., 1988-1992, 1993-1997, 1998-2002, and 2003-2007). This multi-point observation method can show us how the productivist welfare clusters have evolved over time. Also, I choose to use half-decade rather than yearly observation intervals, because a path-dependent tendency is deeply entrenched in most welfare policies in general. As a result, the total number of observations of this research is 44, derived from 4 half-decades of 11 countries. In this study, however, I present the results of the first period (1988-1992) and the last period (2003-2007) only, because the differences in value between adjacent periods are not dramatically significant in many cases and consequently the observations appear crowded around certain spots, making the dendrogram unnecessarily messy and complicated. The simplified two-wave illustration is much easier and more concise to read the results.

The data are from several sources including the Asian Development Bank (ADB), the International Monetary Fund (IMF), the World Bank (WB), the International Labor Organization (ILO), the World Health Organization (WHO), and various statistics yearbooks. While most studies on advanced industrial societies benefit from the wealth of data provided by the OECD, the relative paucity of reliable and comparable data on East Asian welfare states poses a strong challenge. Despite the limitations in scope and accuracy, however, the ADB provides the most useful and comparable array of social policy indicators. For this reason, I use the ADB dataset as a main source for measuring government expenditure on social welfare and health.<sup>32</sup> With regard to institutional forms and population coverage of social insurance and savings programs, I collect data from various national data sources.

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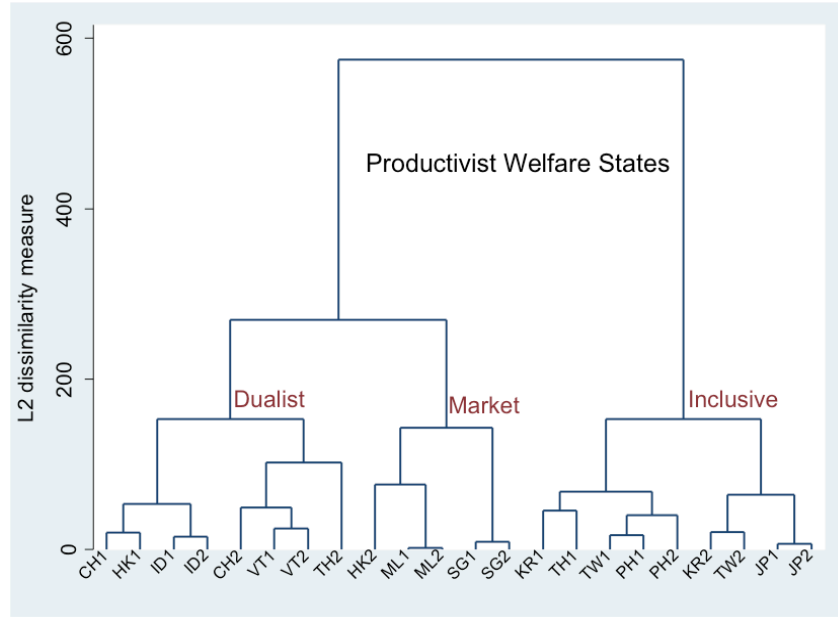
<sup>32</sup> I have checked the reliability of the ADB dataset by comparing with other data sources. When I found any discrepancies in data between resources, I chose to use ADB's data.



#### 2.4.4 Analysis Results and Discussion

The results of the cluster analysis from using STATA (version 11.0) are presented in the following tables and figures. The first step of the analysis is to determine how many clusters exist. Because cluster analysis has no likelihood-based goodness-of-fit index, this study uses a combination of dendrogram (graphic illustration of possible clustering) and stopping rules (Calinski & Harabasz *pseudo-F* statistics and the Duda & Hart  $Je(2)/Je(1)$  indices) as a method to find the appropriate number of clusters (Everitt et al. 2001).

As shown in Figure 6, a dendrogram graphically describes clusters of different productivist welfare states at various levels. The centering points of the dendrogram indicate clusters while the vertical lines of the dissimilarity measure demonstrate the strength of the clustering. The longer vertical lines, the more dissimilar the clusters. As expected, this dendrogram shows three clusters of productivist welfare states—i.e., “inclusive,” “market,” and “dualist.” Although a two-group clustering also seems to be plausible, it is not significant enough to overrule the three-group solution. Rather, it is more reasonable to conclude that many “dualist” states are somewhat inclined to the “market-oriented” system. More specifically, the IPW cluster contains 9 observations derived from Japan, Korea, Taiwan, Philippines, and Thailand. The MPW cluster consists of 5 observations involving Singapore, Malaysia, and Hong Kong. Lastly, the DPW cluster includes 8 observations taking from China, Hong Kong, Indonesia, Vietnam, and Thailand.



**Figure 6.** Dendrogram for Cluster Analysis

*Note:* The number 1 indicates the observation period of 1988 to 1992, and the number 2 is for the period of 2003 to 2007. CH (China), VT (Vietnam), TH (Thailand), TW (Taiwan), PH (Philippines), KR (Korea), MG (Mongolia), JP (Japan), HK (Hong Kong), SG (Singapore), ML (Malaysia), ID (Indonesia)

Regarding the stopping rule, dendrogram does not provide any technical criteria for concluding the most appropriate number of clusters. To obtain the best solution for statistical determination of the number of clusters, scholars have developed several stopping rules such as the Calinski & Harabasz index, the Duda and Hart index, C-Index, Gamma, Beale, etc. (Milligan and Cooper 1985). Among these stopping rules, *pseudo-F* statistics (Calinski and Harabasz 1974) and the *pseudo-T-square* statistics (Duda and Hart 1973) are most widely employed for cluster analyses of continuous data. Duda and Hart's *pseudo-T-square* also provides an associated indicator called  $Je(2)/Je(1)$ . If we find a combination of a large Calinski & Harabasz *pseudo-F* value, a small *pseudo-T-square* value, and a large  $Je(2)/Je(1)$  index, we can determine the most appropriate number of cluster.

Table 4 shows that, when the number of clusters is 3, the Calinski & Harabasz *pseudo-F* value is largest (20.21). In the Duda & Hart values, the indices are somewhat less significant but still substantial. The  $Je(2)/Je(1)$  value is 0.45, and the *pseudo-T-square* value is 8.41. The two-group approach also seems to be possible. The Duda & Hart values are convincing enough to support the rule, but the Calinski & Harabasz indicator reveals the least value. As an alternative, we may consider four clusters. But, while the Calinski & Harabasz index is modest, the significance of  $Je(2)/J(1)$  decreases. Hence, it is hard to claim that the four-cluster model generates the best outcome. In conclusion, this study takes the three-cluster model as accepted, based on the results of the dendrogram and the stopping rules.

**Table 4.** Stopping Rules for Cluster Analysis

No. of Clusters	Calinski & Harabasz <i>Pseudo-F</i>	Duda & Hart	
		$Je(2)/Je(1)$	<i>Pseudo-T-squared</i>
1	.	0.5202	18.45
2	17.15	0.5715	8.25
<b>3</b>	<b>20.21</b>	<b>0.4544</b>	<b>8.41</b>
4	19.00	0.4780	6.55
5	19.39	0.2675	8.22
6	19.78	0.2414	6.29

If three clusters of the productivist welfare state appear to be distinct from one another, how is the significance of their distinctiveness? To address this question, I follow Rudra's (2008, 97) method, calculating the levels of *inclusiveness* and *market-orientation* based on eight IPW indicators and five MPW indicators. The score for each variable ranges from 0 to 100. Table 5 presents the results. The *inclusive* group characterized by the increase of government spending

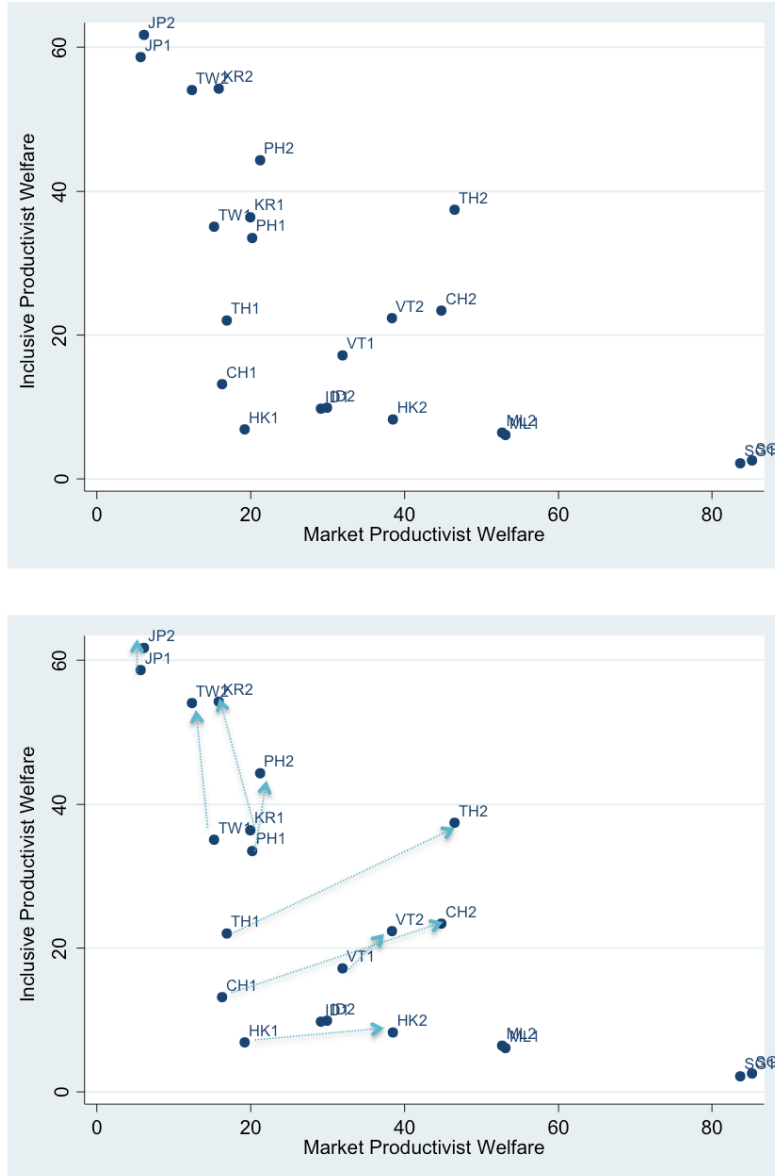
and the expansion of social insurance programs has an average IPW score of 44.4, about 9 times larger than that of the MPW group (5.1). In contrast, the *market* cluster characterized by the transfer of financial responsibilities for social protection from the government to individuals has, not surprisingly, the largest MPW level (64.2) while the *inclusive* productivist welfare group shows an average of 9.8 for its MPW score. In the middle ground, the *dualist* group pursues a combination of social insurance and individual savings programs with a moderate level of government expenditure on social security. Reflecting this characteristic, the *dualist* cluster reveals an average score of 17.3 for IPW and an average score of 27.2 for MPW.

This result confirms the presence of three types of the productivist welfare states. The next question is then whether the variation is static or changing. Scatter plots in Figure 7, which are derived from Table 5, show that East Asian productivist welfare states have evolved markedly to a more *inclusive*, *market-oriented*, or *dualist* pattern over the last decades. In other words, they have become (i) more redistributive by expanding risk-sharing schemes, (ii) more market-oriented by strengthening self-help platforms, or (iii) more dualist by adopting both. The first half of Figure 6 illustrates the status of variation in PWC, and the second reveals the directions of such variations.

**Table 5. Average Levels of IPW and MPW**

Cluster/Country		Indicators for <i>Redistribution through Risk-Sharing</i>									Indicators for <i>Market-Efficiency through Self-Help</i>					
		Govt spending on social security	Govt spending on health	Social insurance (old-age): Eligibility	Social insurance (old-age): Coverage	Social insurance (health): Eligibility	Social insurance (health): Coverage	Social insurance (unemployment): Eligibility	Social insurance (unemployment): Coverage	Country Average	Provident fund (old-age): Eligibility	Provident fund (old-age): Coverage	Provident fund (health): Eligibility	Provident fund (health): Coverage	Private Health Spending	Country Average
IPW	JPN (1988-1992)	18.0	20.7	100.0	103.8	100.0	68.1	10.0	49.5	58.7	0.0	0.0	0.0	0.0	17.0	3.4
	JPN (2003-2007)	24.6	22.4	100.0	106.1	100.0	77.3	10.0	53.2	61.7	0.0	0.0	0.0	0.0	18.3	3.7
	KOR (1988-1992)	9.1	1.9	62.0	24.5	96.0	93.7	0.00	0.00	35.9	0.0	0.0	0.0	0.0	59.9	12.0
	KOR (2003-2007)	17.6	0.8	100.0	73.1	100.0	98.5	10.0	33.8	54.2	0.0	0.0	0.0	0.0	47.6	9.5
	TWN (1988-1992)	18.9	1.4	60.0	82.7	60.0	57.5	0.0	0.0	35.0	0.0	0.0	0.0	0.0	45.7	9.1
	TWN (2003-2007)	24.3	1.4	60.0	85.4	100.0	97.9	10.0	53.5	54.1	0.0	0.0	0.0	0.0	37.0	7.4
	PHL (1988-1992)	0.9	3.2	84.0	57.5	80.0	42.4	0.0	0.0	33.5	0.0	0.0	0.0	0.0	60.5	12.1
	PHL (2003-2007)	4.8	1.6	100.0	73.1	100.0	74.9	0.0	0.0	44.3	0.0	0.0	0.0	0.0	63.6	12.7
	THL (1988-1997)	3.4	7.3	40.0	16.2	40.0	69.0	0.0	0.0	22.0	0.0	0.0	40.0	0.0	50.6	18.1
	<b>Cluster Average</b>	13.5	6.7	78.4	69.2	86.2	75.5	4.4	21.1	<b>44.4</b>	0.0	0.0	4.4	0.0	44.5	<b>9.8</b>
DPW	CHN (1988-1992)	1.7	7.3	40.0	9.0	30.0	0.3	5.0	11.7	13.1	0.0	0.0	0.0	0.0	48.8	9.8
	CHN (2003-2007)	8.1	3.1	60.0	17.4	64.0	13.8	7.0	14.3	23.5	60.0	17.4	60.0	13.8	58.8	42.0
	HKG (1988-1992)	5.6	9.6	20.0	0.0	20.0	0.0	0.0	0.0	6.9	0.0	0.0	0.0	0.0	57.6	11.5
	IDN (1988-1992)	5.3	2.8	20.0	0.0	32.0	0.2	0.0	0.0	7.5	42.0	6.1	0.0	0.0	64.3	22.5
	IDN (2003-2007)	5.5	1.6	20.0	0.0	50.0	1.9	0.0	0.0	9.9	50.0	19.8	0.0	0.0	54.9	24.9
	THL (2003-2007)	9.0	8.3	60.0	22.6	80.0	95.1	8.0	16.4	37.4	30.0	7.5	80.0	95.1	33.1	49.2
	VTN (1988-1997)	12.8	4.3	46.0	15.1	46.0	14.2	0.0	0.0	17.3	0.0	0.0	46.0	14.2	66.3	25.3
	VTN (2003-2007)	8.3	3.3	60.0	14.7	56.0	37.3	1.0	0.0	22.6	0.0	0.0	56.0	37.3	68.9	32.4
	<b>Cluster Average</b>	7.0	5.0	40.8	9.9	47.3	20.4	2.6	5.3	<b>17.3</b>	22.8	6.4	30.3	20.1	56.6	<b>27.2</b>
MPW	HKG (2003-2007)	13.1	12.7	20.0	0.0	20.0	0.0	0.0	0.0	8.2	80.0	64.3	0.0	0.0	43.4	37.5
	SNG (1988-1992)	2.1	5.3	10.0	0.0	0.0	0.0	0.0	0.0	2.2	100.0	92.6	100.0	92.6	58.4	88.7
	SNG (2003-2007)	3.9	6.2	10.0	0.0	0.0	0.0	0.0	0.0	2.5	100.0	88.6	100.0	88.6	66.9	88.8
	MLS (1988-1992)	3.4	5.1	20.0	0.0	20.0	0.0	0.0	0.0	6.1	60.0	46.7	60.0	46.7	52.7	53.2
	MLS (2003-2007)	4.2	7.1	20.0	0.0	20.0	0.0	0.0	0.0	6.4	60.0	46.1	60.0	46.1	52.0	52.8
	<b>Cluster Average</b>	5.3	7.3	16.0	0.0	12.0	0.0	0.0	0.0	<b>5.1</b>	80.0	67.7	64.0	54.8	54.7	<b>64.2</b>

*Note:* See Appendix A for the details regarding the methods of coding and data sources



**Figure 7.** Divergence of Productivist Welfare States, 1988-1999 and 2003-2007

*Note:* The figures are drawn based on the information reported in Table 5.

Until this point, I have empirically demonstrated the presence of three productivist welfare models and their temporal changes. The next logical question is then about what fosters the institutional variation in PWC. I will address this question in Chapter 3. Yet, before moving on

to the next chapter, it would be good to sketch briefly the cases of each model shown in Figure 7, although further explanations about three representative cases will be presented in Chapter 4.

First, among the IPW states, Japan has long held its traditional stance of inclusive welfare programs. At first glance, Japan appears to spend more than any other East Asian productivist welfare states, but its spending is among the least redistributive in the advanced industrial world. To be sure, Japan's aversion to direct cash transfers is evident in its strict means-testing for public assistance (Estevez-Abe 2008, 21). Yet, despite its "meager" social spending, Japan has developed its welfare institutions in an inclusive manner (e.g., the National People's Pension Insurance, Employees' Pension Insurance, Seamen's Insurance, and mutual aid association schemes for government employees and private school teachers) (ibid. 20-30). As such, the Japanese inclusive social protection system stands out for its emphasis on work-based protection.

Korea, Taiwan, and the Philippines have also undergone a marked shift toward a more risk-sharing system over a relatively short span of time. In particular, Korea and Taiwan have witnessed substantial growth in welfare expenditure—though the spending is still insignificant compared to that of European welfare states—and social insurance programs. By the regional standards, the expansion of government spending and social insurance programs are remarkable. This remarkable achievement has led Korea and Taiwan to move upward along the IPW dimension, as seen in Figure 7. Although overall spending on education and social services remains lower, the Philippines have also legislated several social services such as an expansive defined-benefit pension program (1954) and a universal health insurance (1995) (Haggard and Kaufman 2008).

In contrast, the MPW states appear to have been enhancing a *self-help* stance throughout the observed period from the 1980s to the 2000s. Representative cases are Singapore and

Malaysia that have developed provident fund-based schemes (i.e., CPF and EPF) as institutional foundations of social security. In Singapore and Malaysia, the provident fund program originated from a “survival instinct” that was prevalent among political leaders during the industrialization period (Tang 2000, 136). The figure also shows that Hong Kong has moved to this MPW group since 2000 when it adopted a provident fund program (MPF).<sup>33</sup> When Hong Kong was handed over to China in 1997, the new administration signaled a new direction of social policy advocating the principle of “limited state involvement” (Lee 2005). MPF was one of the policy outcomes.

Lastly, China, Thailand, Indonesia, and Vietnam pursue a dualist strategy embracing both IPW and MPW measures. In China, the central leadership has made tremendous efforts to reweave a new social safety net over the last decades. To sustain market reforms and maintain social stability, the Chinese government has been striving for both compulsory insurance schemes and individual savings schemes. For example, the newly proposed pension system consists of multi-pillars of financing, including both inclusive social pool and market-oriented individual account.<sup>34</sup> However, those benefits were initially provided only to formal sectors in urban areas, and urban residents are still the main beneficiaries. Policymakers are increasingly aware that government spending and redistribution through risk-pooling would have multiple positive effects upon China’s socioeconomic development. However, they are also under a strong pressure to cut down the overall cost of welfare provision. Thus, the overarching concerns about the growing marketization of the economy has led China to pursue *dualist* welfare

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<sup>33</sup> To address growing concerns over the aging population, the Hong Kong government adopted the Mandatory Provident Fund (MPF). This was part of the government’s efforts to privatize the existing social security system.

<sup>34</sup> Employers contribute 17 percent of the employee’s wages to social pool and 3 percent to individual accounts, while employees save 8 percent of wage in employees’ individual account as a compulsory retirement plan (Salditt et al. 2008, 55).



programs, resulting in substantial fragmentation of social security benefits between formal sectors in urban areas and informal sectors in rural areas.

Thailand has taken similar steps especially since the 1997 when the Asian financial crisis broke out. The government has developed a social security system combining a social insurance plan (the SSA) for private sector employees on the one hand and a provident fund scheme for state enterprise employees on the other hand. Indonesia also established a provident fund system, called JAMSOSTEK, in 1992. While the scheme is mandatory, almost 90 percent of those in the labor force are not covered by it (Ramesh and Asher 2000, 40-42). Due to severe limitations of state capacity, Indonesia's MPW has been remaining less effective. Interestingly, the health component of JAMSOSTEK is a social insurance run by the government. Thus, the Indonesian government has been experimenting a *dualist* strategy with both individual savings and social insurance schemes.

## **2.5 CONCLUDING REMARKS**

Since the late 1950s, the typology of welfare regimes has been considered one of the most important issues in comparative welfare state studies. As Esping-Andersen (1990, 3) emphasizes, identifying diversity is the foundation on which comparative empirical research can adequately unveil the fundamental properties that unite or divide modern welfare states. Without understanding the diversity of welfare types, it is impossible to address such questions as how and why welfare states differ from one another.

As part of an effort to develop a theoretical framework of East Asian welfare states, Holliday (2000) suggested the so-called "productivist welfare capitalism" (PWC). It offered a

compelling account of welfare state evolution in East Asia. This theory argued that social policy among East Asian developmental states was not intended for social protection via cash transfers, but rather for the promotion of economic productivity. The provision of social security benefits was subordinated to the imperatives of labor production, human capital formation, and sustainable economic growth. According to Holliday, most social policies were designed and implemented by economic policymakers in East Asia.

The PWC theory provided an important insight into East Asian welfare state studies. Yet we can find significant variations among East Asian cases and considerable changes over time. While they share the characteristics of productivist welfarism, they differ in many aspects—especially institutional platforms of social protection. While social insurance schemes are central to Japan, Korea, and Taiwan, provident fund programs are central to Singapore, Hong Kong, and Malaysia. In between, China and Thailand combine both social insurance and provident fund in constructing their social security system. Within the current theoretical discourse, these variations are not well understood. Recognizing the need of a refined theoretical and empirical foundation, this chapter has proposed three models of PWC with theoretical articulation and empirical tests.

First, I presented two conceptual dimensions of social protection—i.e., *redistribution* through *risk-pooling* and *market-efficiency* through *self-help*. Based upon these two dimensions, I proposed three models of the productivist welfare state: *inclusive*, *market*, and *dualist*. To measure the level of “inclusiveness” and “market-orientation” of each model, I surveyed government spending and institutional formats of social protection.

Second, in order to test the presence of the three models of PWC, I conducted cluster analysis with sample size of 44 and found that the East Asian productivist world includes three

subgroups of PWC. This analysis also demonstrated that productivist welfare states are not static but changing over time.

The findings in this research suggest an important implication. It is that, while East Asian welfare states share certain common features, they are not homogenous and rather considerably diverse, so one should be cautious about over-simplification (White and Goodman 1998: 19). Yet here we run into another question: What driving factors are then behind the divergence of PWC? Why have some countries developed *inclusive* institutions of productivist welfarism while some others become more *market-oriented*? The next chapter will address this question.

### **3.0 WHAT DRIVES INSTITUTIONAL VARIATION IN PRODUCTIVIST WELFARE CAPITALISM IN EAST ASIA?**

#### **3.1 INTRODUCTION**

In East Asia, the initial use of social policy was not intended for right-based social protection but rather for the promotion of economic productivity. Social security and welfare benefits were largely subordinated to the imperatives of labor production and were provided to government employees and industrial workers selectively (Peng and Wong 2010, 658). A set of hypotheses regarding this distinctiveness of the East Asian welfare regime resulted in the active scholarly discourse of “productivist welfare capitalism” (PWC) (Holliday 2000). The productivist approach offers a compelling theoretical framework that helps understand the key characteristics of social policy development in East Asia.

A careful examination, however, brings to light important institutional differences among East Asian productivist welfare states. As examined in Chapter 2, there are three types of PWC: (i) inclusive productivist welfare (IPW) that underlines the strategic importance of risk-sharing and fund-pooling; (ii) market productivist welfare (MPW) that focuses on market-efficiency and self-help; and (iii) dualist productivist welfare (DPW) that combines IPW and MPW to a moderate extent. These three strands of PWC are observed across East Asia, with unique institutional mixes. Most of the institutional platforms comprise (i) social insurance-based

schemes with increasing government spending (e.g., Japan, Korea, Taiwan, and the Philippines); (ii) compulsory savings-based schemes (e.g., Singapore, Malaysia, and Hong Kong); and (iii) a combination of both schemes (e.g., China, Thailand, Indonesia, and Vietnam).

Empirical tests in Chapter 2 confirm that variations are real and significant. Yet the finding raises another logical question: Why do some productivist welfare states enter the pathway to IPW while some others choose MPW? What is the factor that fosters the expansion of social insurance programs and government expenditures? What accelerates the growth of individual savings schemes to avoid financial burdens of the government? Under what conditions does this institutional divergence take place?<sup>35</sup>

A number of scholars who were concerned with the issue of welfare state development have competitively proposed rival theories since the early 1960s. However, careful application of those theories to East Asian contexts is rarely carried out. With a few significant exceptions (e.g., Haggard and Kaufman 2008; Rudra 2008), there has been a general neglect of East Asian states in comparative welfare studies. In particular, there are few systematic, coherent, and empirical studies that deal with institutional variation in East Asia's welfare capitalism.

The goal of this chapter is therefore to tackle the question of what is behind the birth and growth of institutional variation in East Asian PWC. My argument rests upon the assumption that, if social security benefits were provided under a certain set of economic considerations, variation in those benefits is an outcome of changes in the economic and political circumstances that had enabled the existing system. In this vein, I present the details of my account as following.

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<sup>35</sup> As seen in Chapter 2, IPW and MPW are somewhat inversely related to each other in a linear fashion, with DPW in the middle. So this chapter focuses its analysis on the conditions under which productivist welfare states become more inclusive or more market-oriented.

First, different levels of exposure to international markets shape different economic structures, building social security institutions suitable for those particular economic structures and strategies. Although it is true that most East Asian developmental states maintained a substantial degree of state autonomy vis-à-vis societal forces and hence were able to pursue state-led export strategies throughout the industrialization period, the extent and form of their reliance on foreign capital and trade were markedly different. For example, Singapore and Hong Kong were engaged in “market-conforming” developmental strategies (e.g., open financial markets and the extensive role of foreign firms) while Japan, Korea, and Taiwan pursued “market-distorting” developmental strategies (e.g., closed financial markets and the promotion of domestic firms).<sup>36</sup> This kind of differences created conditions under which economic globalization has brought different impacts on East Asian economies. Indeed, market-oriented welfare institutions were more popular among “market-conforming” economies, because redistributive social security methods were perceived as adverse to the attraction of foreign investment. In contrast, inclusive welfare measures that primarily benefited skilled workers were more prevalent in economies with “market-distorting” traditions, because social protection of employees in formal sectors was an important part of the state-led economic development strategy. As such, productivist welfare states have developed different types of social security institutions, depending on the extent of economic liberalization, despite their similar approach to the instrumentality of social policy.

Second, political pressure is another factor that nurtures institutional variation. Like many other welfare state studies, this study focuses primarily on the positive relationship between

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<sup>36</sup> The conceptual distinction between “market-conforming” and “market-distorting”—or between government’s leading or following the market—is made in Wade (1990, 28). Amsden (1989) also uses this distinction to explain Korean government “distorted” prices to get growth up.

democratic competition and the expansion of redistributive social protection schemes. In general, due to the need to secure a broad electoral base, politicians in democratic regimes are more responsive to the demand and political pressures for social protection of the citizens. That is, democratic regimes are more likely to have a stronger social policy commitment. For example, the introduction of democratic electoral competition in Korea and Taiwan led the ruling parties to begin to use social insurance and public assistance programs as a means of gaining political support. Such benefits were initially used selectively for government employees and industrial workers who were considered strategically important in authoritarian Korea and Taiwan; however, they have increasingly extended the benefits to virtually the whole population after they became democratized in the late 1980s.

Regarding the positive relationship between political pressure in democracies and the expansion of inclusive welfare measures, we need to remember that political factors (e.g., political pressure) are more influential to the *growth* of the institutional variation of PWC while economic factors (e.g., economic openness) tend to activate the initial divergence of the variation. In other words, whether adopt social insurance-based IPW or individual savings-based MPW is primarily dependent on economic considerations while the further and continuing progress of the variation is greatly influenced by political factors.

This chapter is structured as following. In the next section, I review existing theories, pointing out their limitations in explaining the institutional diversity of PWC. In the third section, I introduce my theoretical perspectives, looking at the underlying economic and political dynamics that cause institutional variation in productivist welfarism. In the fourth section, my argument is tested with a cross-sectional time-series data set. The last section presents a conclusion.

## **3.2 LITERATURE REVIEW**

There are a number of theoretical explanations for the origin and development of the welfare state. Most of them can be categorized broadly into two domains depending on whether they focus on economic factors or political factors. Even though all these explanations contribute to our understanding of welfare state development, we know little about underlying causal factors behind East Asian welfare states. It is because the current theoretical discourses are mostly based on the experiences of Western industrial democracies. Despite the recent increase in the number of studies that deal with the developing world, East Asia is still among the least studied topics of comparative welfare research. In this section, I review a range of relevant theories to see what insights they can offer and what limitation they have.

### **3.2.1 Economic Theories of the Welfare State**

Economic theories of the welfare state are based upon the functionalist assumption that economic conditions such as growth and openness are a root cause of the welfare state. This strand includes three domains: (i) the logic of industrialization; (ii) the logic of capitalism; and (iii) the varieties of welfare capitalism (VOWC).

First, many of early welfare state studies view industrialization as exerting pressure on governments to address the increase of welfare needs (Aaron 1967; Cutright 1965; Kerr et al. 1960; Pampel and Williamson 1989; Pryor 1968; Wilensky 1975; 2002; Wilensky and Lebeaux 1958). The main thrust of the industrialization theory is that the emergence of the welfare state is related with structural changes such as the division of labor, massive migration from rural to urban areas, cyclical unemployment, and growth in an aged and urban population. They assert



that industrialization generates these profound changes with the transformation of family and community life. The decrease in traditional welfare provision of family members causes the overall increase of welfare needs, making many vulnerable people unable to find adequate welfare supports. As such, industrialization and subsequent demographic changes are understood as the main reasons for the emergence of the welfare state.

Early empirical studies on developed countries demonstrate that there is indeed a positive correlation between the level of industrialization and aggregate social spending (Wilensky 1975). However, this correlation disappears if one repeats the analysis including both developed and less developed countries together in the sample (Mares and Carnes 2009, 96). Moreover, because the industrialization approach assumes that all advanced economies have undergone a similar transition from agrarian to industrial capitalism and would converge to the same type of welfare provision, it cannot provide any hint as to why the most industrialized countries like Japan, Korea, Taiwan, Singapore, and Hong Kong develop different forms of productivist welfare institutions.

Second, Neo-Marxist and other radical theories constitute another line of the industrialization approach, yet their major interest is in the contradiction between capital accumulation and political legitimization. According to Neo-Marxist theories, capitalist states expand social provision as a means of political legitimization to create an environment conducive to profitable capital accumulation (Gough 1979; O'Connor 1973; Offe 1984). Because capitalist states desire to avoid labor unrest while securing capital accumulation, welfare efforts are viewed as a useful method to aid the market. Indeed, as Polanyi (1944) argues, social protection does often rescue the market from failures. Paradoxically, however, the expansion of social welfare to strengthen their legitimacy results in a fiscal crisis, which in turn contradicts the

logic of capitalist accumulation (O'Connor 1973). The prospects for the welfare state are, therefore, pessimistic as the contradiction endangers capital accumulation. By focusing on the contradiction embedded in the capitalist form of production, the Neo-Marxist account provides an insightful perspective on the origin of welfare state development. However, due to its undifferentiated conception of capitalism, the Neo-Marxist approach also fails to explain why capitalist states develop different types of welfare institutions.

Third, in order to overcome the fundamental limitations inherent in the above functionalist convergence approaches, a number of scholars turn their attention to the possibility of different capitalist models. The “varieties of capitalism” (VOC) theory, which was introduced by Hall and Soskice (2001) and now widely referred to in the literature, argues that differences in the institutional framework of capitalist economies generate systematic differences in corporate governance, labor relations, vocational training, and inter-firm relations. That is, capitalist economies with a particular type of coordination in one sphere of the economy tend to develop “complementary institutions” in other spheres as well. Based upon the notion of institutional complementarities, the VOC theory classifies capitalist economies into two ideal types: liberal market economies (LMEs) and coordinated market economies (CMEs). CMEs are characterized by the prevalence of nonmarket-oriented measures, collaboration, and credible commitments among firms whereas LMEs are portrayed essentially as a system of market-oriented competitive relations, formal contracting, and supply-and-demand price signaling (Hancke 2009, 4). Due to their contrasting features, CMEs and LMEs are often described in the following dichotomous terms: long-term finance (CMEs) vs. short-term finance (LMEs); regulated labor markets (CMEs) vs. flexible labor markets (LMEs); vocational training (CMEs) vs. general training

(LMEs); and inter-firm coordination (CMEs) vs. inter-firm competition (LMEs) (Hall and Soskice 2001, 32).

Noticing the useful property of the VOC thesis concerning cross-national differences in corporate strategy and behavior, recent studies attempt to incorporate the central assumptions of VOC into the question of how different types of production regime generate different patterns of welfare state development (e.g., Ebbinghaus and Manow 2001; Huber and Stephens 2001; Iversen 2005; Mares 2003; Swank 2002; Swenson 2002).<sup>37</sup> Indeed, many studies demonstrate that there are “elective affinities” between capitalist models and welfare regimes—e.g., corporate governance and pension system (Jackson and Vitols 2001) and skill formation and employment protection (Estevez-Abe, Iversen, and Soskice 2001). As such, the so-called “varieties of welfare capitalism” (VOWC) attributes varieties of welfare state development to distinctive configurations of financial system, corporate governance, labor relations, and employment relations. Particularly, the VOWC argument is useful to identify the conditions under which states adopt different types of welfare policies in the initial stage of industrialization. In short, the VOWC theory views different sets of economic institutions and market strategies as independent variables for different types of social protection (Mares and Carnes 2009: 101).

The findings in the VOWC literature have prompted another group of researchers to examine the relationship between development strategies and welfare policies in the developing world (e.g., Haggard and Kaufman 2008; Rudra 2008; Wibbels and Ahlquist 2011). All of these studies identify East Asia as a region wherein human capital formation—i.e., education and skill

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<sup>37</sup> For last decades, the link between specific economic system and particular forms of social protection was not adequately addressed, mainly due to the view that the function of the welfare state is often constraining the market (Ebbinghaus and Manow 2001, 11). However, the welfare state is not always an institutional counter-principle of capitalism. Rather, economic strategies of firms and other actors are complementary to particular social policies and labor-market institutions (Haggard and Kaufman 2008, 2).

training—is the centerpiece of social policy. I believe this is a great progress in comparative political economy. However, although they correctly understand the key nature of East Asian welfare states, the question that I have raised still remains unanswered. Why is there systematic variation within the productivist world of welfare capitalism in East Asia? Even though many economic studies demonstrate that East Asian NIEs are not homogeneous and identical in terms of industrial policy, the extent and form of reliance on foreign investment, and the state-society relationship (Hughes 1988; Kwong et al. 2001; Patrick and Park 1994; Ramesh 1995), few studies examine the impact of these marked differences on the institutional divergence of East Asian PWC. In this respect, it is necessary to examine whether and how the extent and pattern of economic openness and developmental strategies influence institutional variation in PWC.

### **3.2.2 Political Theories of the Welfare State**

Rapid industrialization and the subsequent demographic changes might explain the dramatic expansion of social welfare that occurred in Europe during the early postwar era (Cutright 1965; Wilensky 1975). Economic globalization and the arrival of neoliberal initiatives are believed to have intensified the pressures for welfare retrenchment at the global level since the 1980s (Mishra 1999; Scharpf 2000; Strange 1996). However, all these economic theories of the welfare expansion and retrenchment have their limitations in explaining what differentiate welfare state development across countries in the face of pressures for welfare expansion or cutback. Although the economic theories provide valuable insights into the wax and wane of the welfare state, it is misleading to view the institutional linkages between economic factors and social protection as unconditional because political factors also can influence welfare state development substantially. This notion has led many scholars to propose several political theories.

The first political theory of the welfare state is the “power resources” approach. This theory contends that welfare state development is a result of the historical strength of working-class forces articulated through labor unions and left-wing parties in the continuing struggle with the powers of capital (Esping-Andersen 1990; 1996; Huber and Stephens 2001; Korpi 1983; 1989; O’Connor and Olsen 1998; Shalev 1983). The central assumptions are as following: (i) unequal economic relationships shape basic cleavage between social classes with distinct and competing interests; and (ii) elections provide a set of opportunities for those classes to get benefits. Because working-class people vote for left-wing parties in general while upper-middle-class people will vote for right-wing parties, government spending on welfare depends on the relative strength of working classes, combined with various institutional conditions.<sup>38</sup> As such, the power resources theory views class struggle as the central determinant of cross-national variation in welfare state development. A number of empirical studies support the power resources theory (Castles 1982; Esping-Andersen 1985; Heidenheimer et al. 1990; Hewitt 1977; Korpi 1989; Myles 1988; O’Connor 1988).

However, a new scholarly approach emerges, labeling the theory of power resources and class conflicts as an “old politics” of welfare state. The so-called “new politics” of welfare state argues that the constitutional structure of the governments actually determines the range of social policy options and strategies (Immergut 1992; Pierson 1994; 1996; 2001; Swank 2002). This approach employs the case of conservative governments in the UK and the US to explain why attempts to reduce welfare programs have failed in Western democracies. The “new politics”

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<sup>38</sup> However, it is also argued that indicators such as the size and density of labor unions and the percentage of Left votes in national elections do not exactly catch the real strength of working classes because, in most countries, the unionized constituency of leftist parties is too small to gain control of the government (Segura-Ubiergo 2007, 9). Moreover, it is doubtful to assume that workers are strongly united with shared interests. Offe (1984) argues that it is more realistic to assume that strategic alliances encompassing working as well as middle classes are pivotal for the establishment, extension, and maintenance of comprehensive welfare states.

camp argues that governments with a higher level of vertical and horizontal decentralization are less likely to change the existing system, due to the larger number of veto players whose agreement is necessary for a change of the status quo (Tsebelis 2002). Building upon two central assumptions of (i) the welfare state's enduring popular support and (ii) its institutional inertia, the "new politics" theory highlights the impact of political institutions such as federalism, bicameralism, and a powerful presidential system on welfare state development (Starke 2006).<sup>39</sup>

Although both "old" and "new" politics are competing theories that enrich our understanding of welfare growth and retrenchment, they are not exactly fit to the East Asian context. First, when East Asian productivist welfare states launched a series of social programs, they had neither significant left-wing parties nor organized labor union movements (let alone powerful civil society and interest groups). Unlike the assumption of the power resource theory that is based on the historical experience of working class coalition in the Nordic countries (Esping-Andersen 1990), the implementation of East Asia's inclusive welfare programs was not due to the pressure from labor unions or any active role of left-wing parties. Prior to democratization, most class-based movements and cross-class alliances were violently repressed by the state in East Asia. Even when labor acquired power during the democratization period (e.g., Korea and Taiwan), its interest was mostly limited to wage-related issues like minimum wage increases (Hwang 2006).

Secondly, the divergence of PWC in East Asia also presents challenges to explanations of the "new" politics that emphasize the constraining effects of previous policies and institutions. According to Pierson (1994; 2001), past policy commitment often limits present options, creating

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<sup>39</sup> Many scholars who disagree with the new politics theory attempt to show that the "old" politics still matter (Garrett 1998). Yet empirical findings are rather inconclusive. Some scholars find evidence of partisan effects on welfare expenditure in favor of the old politics theory (Garrett 1998), whereas some others find evidence against it (Swank 2002). Mixed results are also reported (Huber and Stephens 2001; Kittel and Obinger 2003).

a “lock-in” effect regardless of the preference of the existing government. An important implication of this approach is the “stickiness” of existing policies and institutions (Mares and Carnes 2009, 106). However, as seen in Chapter 2, East Asian productivist welfare states have developed different pathways toward more inclusive or more market-oriented ways in spite of their long-standing principle that social policy is subordinated to the overriding policy objective of economic growth. Of course, the future direction of IPW and MPW institutions will be influenced by the current policy trends. Yet, what we need to identify at this moment is the “path-departing” condition rather than the “path-depending” effect.

To address the limitations of the class- and institution-focused theories, scholars begin to bring the *state* back in. They view the paternalistic actions of state bureaucrats and the policy-making capabilities as the source of the origins and development of the welfare state (Evans et al. 1985; Heclo 1974).<sup>40</sup> In this theoretical framework, state bureaucrats are assumed to have clear objectives and motivations and possess technical knowledge relevant to the implementation of their policies. Historical evidence shows that state bureaucrats, who are autonomous or partially autonomous from social pressures, often have their own interests in the establishment of specific welfare regime.

The state-centered approach is useful particularly when we examine authoritarian states that have a strong paternalistic tradition. For example, Bismarck launched health insurance and pension programs in the 1870s to legitimate his rule on the one hand and woo workers away from the radical promises of the new social democratic movement on the other (Flora and Heidenheimer 1981). East Asia also took similar steps, thus employing social policy as an integral part of state-building. In East Asia, civil servants and military personnel were early and

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<sup>40</sup> Trying to avoid the pitfall of identifying politicians as the representatives of the state, this state-centered approach understands the state as an institutional set of rules in which government officials pursue their policy preferences.

main beneficiaries of publicly financed social security programs. The ruling elite developed those generous programs to reinforce the bureaucracy and military's loyalty to the regime, which was considered as a prerequisite to rapid economic growth (Ramesh and Asher 2000, 9).<sup>41</sup> To be sure, the PWC theory is in lines with the state-centered approach. However, we need additional explanations about why some state leaders expand inclusive social insurance programs while some other state leaders construct market-oriented savings programs resulting in institutional diversity of PWC.

### **3.3 THE DEVELOPMENT OF PRODUCTIVIST WELFARISM AND ITS INSTITUTIONAL DIVERGENCE**

As examined in Chapter 2, East Asia's developmental strategies are interconnected with a particular set of productivist welfare principles. Despite this coherent developmental proposition, however, why do productivist welfare states exhibit substantial variations? Why do some productivist states become more inclusive while some other productivist welfare states become more market-oriented?

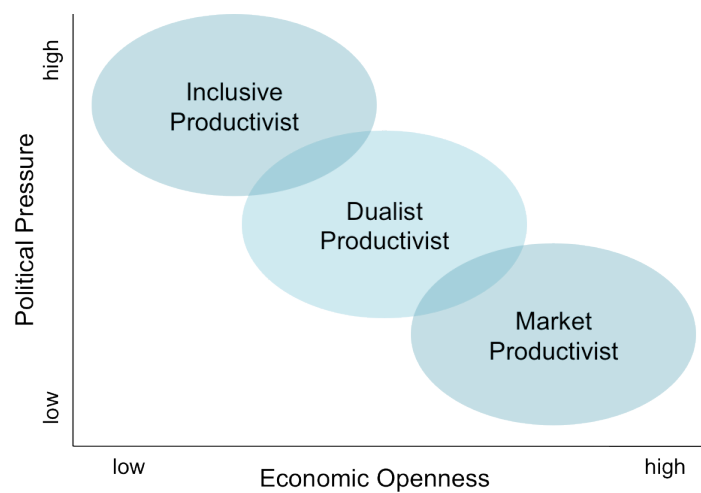
This section provides two explanations for this question. First, East Asian states have nurtured two trajectories of the developmental paradigm, which in turn affects institutional divergence of PWC. Particularly, the extent to which they are integrated into foreign investment and trade is a main causal factor lying behind the variation. The second argument is that, due to a

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<sup>41</sup> The East Asian model is in line with neo-Marxism in terms of that both believe that states promote social policies to serve capitalist interest. But, they differ substantially in other respects, particularly their views on state autonomy and the origins of the social policies. Whereas the neo-Marxist theories consider states as a tool of the capitalist class, proponents of the productivist welfare state view states as autonomous entities insulated from the influence of business groups (Smuthkalin 2006, 7).



higher level of bottom-up political pressure, democratic regimes tend to have more inclusive social security measures. Democratic governments are believed to be under pressure to enlarge social protection provision, derived from electoral competition and the strategic imperatives of political entrepreneurship. That is, the extension of IPW is an outcome of democratic transition and bottom-up political pressure. Figure 8 illustrates my theoretical arguments succinctly.



**Figure 8.** Three Worlds of Productivist Welfare Capitalism

### 3.3.1 Economic Openness and the Divergence

It is believed that during the industrialization period, East Asian states possessed exceptional state capacity and autonomy with which they have promoted export-led development (Woo-Cumings 1999). Although this is a valid generalization, we must not underestimate the existence of marked differences in the type of industry they promoted, the extent and form of their reliance on foreign capital, and the level of autonomy from social forces. It is because, far from being

superficial, these differences have played an important role in shaping welfare systems in East Asia (Ramesh 1995, 234).

In particular, the pattern of access to foreign capital and the level of trade are closely related to East Asia's industrialization strategies and social policies. Although there is no shortage of literature on trade and foreign capital flows in East Asia, however, few studies have examined the relationship between economic openness and social protection. Just as the causal nexus between economic globalization and welfare state development is a hot-button issue in comparative welfare studies (e.g., Rodrik 1997; Garrett 1998; Burgoon 2001; Huber and Stephens 2001; Rieger and Leibfried 2003), this section brings particular attention to the impact of economic openness on productivist welfare states.

### **3.3.1.1 Foreign Capital**

Over the period from the 1960s to the 1990s, East Asia achieved rapid industrialization as a whole, moving from labor-intensive to capital-intensive/high-tech industries at a different pace (Wan 2008). East Asia's economic success was due in part to high savings and investment rates that enabled a rapid build-up of capital stock. The export-oriented approach also turned East Asia into one of the most attractive places to invest. Yet, the nature and magnitude of foreign capital in East Asian economies vary, being largely determined by host countries' industrial policy.<sup>42</sup>

Along with the emphasis on exports, the aim of industrial policy in Japan, Korea, and Taiwan was to build a vertically integrated economy in which some of the strategic industries

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<sup>42</sup> The principal forms of foreign capital flows include foreign aid, trade credit, bank loans, FDI, and portfolio investment. The form of early capital inflows into East Asian economies was foreign aid, followed by export credit, bank loans, FDI, and portfolio investments, as East Asia became credit-worthier for commercial capital flows. The type of capital inflows was largely congruent with one's industrial policy and the stage of development (Parry 1988, 97).

could be sustained through a close connection with the state and banks.<sup>43</sup> As epitomized by Johnson's classic study (1982) of Japan's MITI (Ministry of International Trade and Industry) and later refined in the works of Amsden (1989) and Wade (1990), industrial policy in East Asia had an entrepreneurial function that nurtured and disciplined business to achieve rapid growth. For example, MITI created Japan Electronic Computer Corporation (JECC) to ease the cash flow problems of local computer producers and sponsored collaborative research projects on semi-conductors, which were an essential factor that made Japanese corporations competitive in the global market of information technology (Evans 1998, 76). In such a setting, foreign capitals could enter only under regulatory auspices.

By contrast, Singapore and Hong Kong successfully built an entrepôt economy, where international capital was given better infrastructure with less state regulation. Of course, Singapore, for example, also created a government agency—the Economic Development Board (EDB)—that is widely regarded as the key to Singapore's industrialization. Yet the role of the EDB was fairly different from that of Japan's MITI. The EDB was in charge of attracting foreign investment rather than controlling domestic industries. To foreign investors, the EDB was a competent organization that provides a “one-stop” service in the areas of construction, recruitment, immigration, employment relations, factory space, housing for employees, taxation, suppliers, etc. (Kwong et al. 2001, 22-24). Hong Kong also set up a similar mechanism that favors foreign investment for industrialization purposes. This “market-conforming” orientation made Singapore and Hong Kong emerge as a new center of international finance, commerce, and trade in the region—which is exalted as a market-friendly model that “gets the fundamentals

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<sup>43</sup> Industrial policy refers to “an effort by a government to alter the sectoral structure of production toward sectors it believes offer greater prospects for accelerated growth than would be generated by a typical process of industrial evolution according to static comparative advantage” (Noland and Pack 2003, 10). The essence of industrial policy is “selective state intervention” which is one of the secrets of economic success in East Asia (Wan 2008, 214).

right” (World Bank 1993).<sup>44</sup> Table 6 shows a contrasting feature between “market-distorting” and “market-conforming” economies.

**Table 6.** FDI Inflow in East Asia

	% of gross fixed capital formation (annual average)					
	1985-1995	2001	2002	2003	2004	2005
Japan	.	0.6	1.0	0.7	0.7	0.3
Korea	1.0	2.6	1.9	2.1	3.8	3.1
Taiwan	3.0	7.8	2.9	0.8	2.8	2.3
Philippines	7.4	7.0	13.3	3.7	4.8	7.5
Thailand	4.2	14.6	3.3	5.7	3.4	7.2
Indonesia	3.4	-9.4	.	-1.3	3.4	8.5
Vietnam	28.3	13.6	11.0	11.0	10.5	11.3
China	6.0	10.5	10.4	8.6	8.0	9.2
Malaysia	13.8	2.5	14.5	10.8	19.1	15.2
Singapore	32.9	55.5	25.6	46.5	58.0	78.9
Hong Kong	18.4	55.7	26.4	40.6	96.4	97.0

*Source:* Data for 1985-1995, 2001, and 2002 are from UNCTAD, *World Investment Report 2005*, country fact sheets). Data for 2003-2005 are from *World Investment Report 2006*, country fact sheets.

Among others, Korea and Singapore are two representative cases that illustrate the key aspects of “market-distorting” and “market-conforming” approaches, respectively. The two cases show a quite different picture, especially regarding the roles and impacts of foreign capital. In Korea, foreign borrowing was a more important source of funds for state-led industrialization than foreign direct investment, partly because interest rates on foreign borrowings were substantially

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<sup>44</sup> Malaysia and Thailand also achieved economic development successfully, combining the different experiences of the first generation of East Asian NIEs with their own strategies. For example, Malaysia implemented the 1970 New Economic Policy, which was to increase domestic capital owned by the native Malaysia by up to 30 percent. This was renamed the National Development Policy in 2000 (Kwon 2009, 14). China is also unique in terms of that local governments appeared to be competing to attract foreign investment while the central government dismantled the existing socialist system without radical changes in its political control.

below domestic market rates and, more importantly, because the government did not need to concern about any significant limits on state autonomy and national industrial policies that would have otherwise been constrained. As a result, the average of Korea's borrowing was close to 5 percent of GNP from the late 1960s to the early 1980s under the government's tight control over the process (Patrick and Park 1994, 330).

In contrast, Singapore relied heavily on foreign capital during the industrialization period (Rodan 1989). Between 1975 and 1990, FDI formed about 30 percent of total capital formation in Singapore while it was about 1 percent in Korea. This ratio of foreign investment to gross fixed capital formation is certainly one of the highest among the Asian NIEs (Yeung et al. 2001, 163). Similarly, while net FDI formed only 12 percent of total foreign capital inflow in Korea during the same period, it formed 102 percent in Singapore. Throughout the 1980s and into the early 1990s, Singapore attracted over 10 per cent of all FDI received by countries outside the OECD (Perry et al. 1997, 15). Not only did Singapore have a higher level of FDI, but it also had a higher proportion of firms owned by foreigners (72.6 percent as of 1989), compared to Korea (50.4 percent). As can be expected, foreign firms played a much more important role in Singapore than in Korea. In the latter's manufacturing sector, they accounted for about 10 percent of employment and about 30 percent of exports between 1978 and 1986. In Singapore, they were responsible for about 60 percent of employment and 90 percent of exports during the same period (Parry 1988, 111-116).<sup>45</sup> Thus, "market-distorting" Korea and "market-conforming" Singapore have developed different approaches to foreign capital.

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<sup>45</sup> It is reported that Singapore is hosting 3000 foreign firms as of 1995, 700 of which are in the manufacturing sector (Yeung et al. 2001, 163)

### 3.3.1.2 Financial System

As examined above, East Asian states have revealed contrasting patterns of economic strategy despite the same goal of rapid industrialization. The distinctive approaches to foreign capital have, in turn, produced different types of financial system. Indeed, East Asian developmental states intervened in or regulated their financial market to different extents (Stubbs 2005, 9). During the industrialization period, Japan, Korea, and Taiwan were more interventionist and directive than their market-conforming counterparts. The governments established a closer alliance with local firms and banks, using their regulatory powers to keep foreign capital screened. The financial system in Japan, Korea, and Taiwan was essentially closed, insulated from foreign markets and players.<sup>46</sup> In the latter cases, by contrast, the overall level of penetration by foreign capital was relatively high. Without doubt, foreign firms and foreign capital has played a significant role in Singapore and Hong Kong, contributing to the industrialization and the development of open financial market.

Zysman (1983) categorizes these two patterns into “bank credit-based” and “capital market-based” financial systems, which are directly related to the VOC framework introduced by Hall and Soskice (2001).<sup>47</sup> The classical distinction between coordinated market economies (CME) and liberal market economies (LME) highlights that CMEs are characterized by the pre-eminence of non-market coordination ensuring the availability of long-term finance and corresponding economic institutions (e.g., regulated labor markets, vocational training, and

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<sup>46</sup> A few foreign banks were allowed to establish branches to finance foreign trade, because U.S. (and later Eurocurrency) interest rates were lower than domestic rates until the 1970s in Japan and later in Korea and Taiwan. However, foreign financial institutions could play only with small market shares (Patrick and Park 1994, 330).

<sup>47</sup> In comparative institutional studies, the difference in the relative importance of banks and capital markets is a general criterion to draw a distinction between two types of financial system. More recently, similar attempts have been made at classifying systems along similar dimensions. For example, while Rybczinski (1985) uses “*bank-oriented vs. market-oriented*” financial system, Berglof (1997) and Franks and Mayer (2001) use the concepts of “*debt-based vs. equity-based*,” “*intermediated vs. securities-based*,” and “*insider vs. outsider*” financial systems.

extensive coordination among firms). In the credit-based financial system of CMEs, banks play a leading role in mobilizing savings, allocating capital, overseeing the investment decisions of corporate managers, and providing risk management vehicles.

In contrast, LMEs emphasize the limited role of the state and a low level of regulation and taxation. In the market-based financial system of LMEs, capital markets share center stage with banks, getting society's savings to firms, exerting corporate control, and easing risk management (Berglof 1997). It is believed that bank-based systems are better able to provide stable long-term finance to the corporate sector, which in turn enables companies to make long-term commitment to employees. Such systems create the supply of "patient" capital in contrast to "liquid" capital in market-based financial systems that subject companies to more pressure for short-term profits and less secure employment policies (Jackson and Vitols 2001, 173).

The credit vs. market typology fits East Asian cases. Certainly, domestic banks have played a significant role in the "market-distorting" economies where foreign capital was constrained. For example, the Japanese government created a financial system that separated long-term banking from short-term banking and banks from security firms, with specialized banks and administrative guidance from the Ministry of Finance (Hutchison et al. 2006). Unlike in the U.S. where banks keep an arm's length from firms, Japan created a keiretsu—an industrial group system—in which groups of companies were built around a main bank at the core. The banks and firms had an interlocking long-term relationship with cross-shareholdings under the government's control and support. Between 1954 and 1984, Japanese nonfinancial sectors received most external funding through bank loans (45-63 percent) and trade credits (20-36 percent) rather than stocks (4-15 percent), bonds (2-5 percent), or foreign direct investment. The shares of stocks actually decreased from 15 percent in 1954-1958 to 6.1 percent in 1979-1983.

This types of financial system provided Japanese firms with substantial advantages and ensured access to financing and financial services from banks throughout the 1980s (Wan 2008, 284). Similarly, a controlled and bank-based financial system was prevalent in Korea and Taiwan too.<sup>48</sup>

Although industrial policy supported by a bank-based financial system has been broken down since the late 1980s when the process of financial liberalization was accelerated with the rise of the neoliberal ideology in East Asia, the government's control on bank lending and episodic political intervention continued, coupled with the deregulation of nonbank financial institutions (Hamilton-Hart 2008, 46). As a result, the "market-distorting" economies managed to have a long-lasting legacy of bank-based financial system. The financial structure index (FSI)<sup>49</sup> in Table 7 displays the relative importance of banks and capital markets between "market-distorting" and "market-conforming" economies in East Asia (Demirguc-Kunt and Levine 2001). While Singapore, Hong Kong, and Malaysia have a higher level of market capitalization (1.18 to 2.93), Japan, Korea, and Thailand have a lower level (-0.19 to 0.89).<sup>50</sup> This is not a surprise, considering that the former economies opened their capital market widely to foreign investors since the very beginning of industrialization.

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<sup>48</sup> During the industrialization period, state-owned banks dominated Taiwan's banking sector. The government controlled the banking sector tightly, setting interest rates on the one hand and restricting entry of new banks on the other hand. The government provided bank credit to favored state enterprises and exporting firms. As a result, bank loans accounted for 70 percent of the total financing from money market, capital market, and domestic banks in 1977 and 60.7 percent as late as 1984 (Wan 2008, 285).

<sup>49</sup> The financial structure index quantifies the level of market capitalization, derived from an average of three indicators: the ratio of market capitalization to bank assets ("size"), the ratio of total value of equities traded to bank credit ("activity"), and total value of equities traded/GDP multiplied by overhead cost ("efficiency"). For further information, see Demirguc-Kunt and Levine (2001).

<sup>50</sup> According to another study, Singapore's FSI increases if the cyclical component is removed from the FSI indicators (Park et al. 2005).



**Table 7.** The Level of Market Capitalization in East Asia (2001)

Country	Financial Structure Index (FSI)	Financial System
Korea Japan Thailand	0.89 – 0.19 0.39	Bank-based
Singapore Hong Kong Malaysia	1.18 2.10 2.93	Market-base

*Note:* Demirguc-Kunt and Levine categorize Korea and Thailand as a market- based system in their study. But the index clearly indicates that these countries have a lower level of market capitalization, compared to their “market-conforming” counterparts.

*Source:* Adapted from Demirguc-Kunt & Levine (2001)

### 3.3.1.3 Trade

Trade is another area wherein we can detect differences between “market-conforming” and “market-distorting” economies. Of course, it is undeniable that strong export performance has been the key to the East Asian economic miracle. Throughout the whole process of industrialization, East Asian NIEs have created almost a cult of export. Starting with Japan, they have relied heavily on exports, which were highly beneficial to economic growth (Wan 2008, 237-269). According to *World Development Indicators* of the World Bank, East Asian states, let alone Japan, achieved an 11.5 percent average annual growth rate in trade in 1970-1995, twice as fast as the world average of 5 percent. Their share in world trade increased from 4 percent to 16 percent in the same period (World Bank 2000).

Nonetheless, East Asian economies are in sharp contrast in terms of the amount of export and import measured as a percent of GDP. Although Japan is a major trading nation, its exposure to international trade actually did not change considerably, hovering around 20 percent in 1960-2005 (Table 8). Trade in Korea and Taiwan also showed lower than 100 percent of GDP until the

2000s. Not surprisingly, Hong Kong has a high exposure to international trade. Singapore is also as much dependent on trade as Hong Kong. China's trade as shares of GDP increased dramatically from 5 percent in 1970 to 63.6 percent in 2005. This different level of dependence on trade has led East Asian states to become more vulnerable or less than others to changes in the global market.

**Table 8.** Trade in East Asia (Average)

Export and Import as % of GDP					
	1981-1985	1986-1990	1991-1995	1996-2000	2001-2005
Japan	27.17	18.67	17.06	19.85	23.25
Korea	68.07	63.58	55.02	69.95	71.18
Taiwan	96.28	92.56	86.87	94.71	109.56
Philippines	48.38	55.21	70.20	104.13	102.48
Thailand	49.23	64.40	81.92	102.04	131.26
Indonesia	49.39	45.18	51.82	67.76	61.25
Vietnam	.	40.44	71.79	99.87	127.83
China	22.87	32.58	44.15	39.13	56.46
Malaysia	106.59	124.63	167.98	202.98	203.88
Singapore	355.85	350.54	335.14	344.03	399.96
Hong Kong	191.31	238.33	270.79	263.17	330.56

*Source: Penn World Table 6.3 (2009); World Development Indicators (WB).*

It is of course true that the overall volume of trade in East Asia is much more than that of most of the world. However, the utilization of an export-led development and a larger volume of trade do not necessarily imply the liberalization of trade. Hence, it is useful to look at the rate of tariffs instead because it shows a better picture disclosing noticeable differences in trade

liberalization.<sup>51</sup> As seen in Table 9, Hong Kong's mean tariffs rates have been 0 percent, and Singapore's rates are also close to 0 percent, which means that their export and import were promoted along with trade liberalization. The rest of East Asia has gradually reduced tariffs rates since the 1980s, but the pace and extent varied. While most Southeast Asian economies drastically reduced the rates, Korea and Taiwan's reduction rates have been slower and much less significant. Obviously, "marketing-conforming" economies tend to have lower tariff rates whereas "market-distorting" economies have higher rates of tariff. The next logical question is then how these contrasting features of different economic strategies are related to institutional variation in PWC.

**Table 9.** Trade Taxes and Tariffs in East Asia

	Taxes as % of Exports and Imports				Mean Tariff Rates			
	1980	1990	2000	2004	1980	1990	2000	2004
Japan	0.9	0.9	1.5	1.5	9.5	6.9	4.5	2.9
Korea	4.1	3.4	1.3	1.3	20.4	13.3	8.7	9.3
Taiwan	3.6	2.1	1.5	0.8	-	9.7	8.8	6.9
Philippines	6.8	6.6	2.7	2.5	38.0	24.3	7.6	4.4
Thailand	6.9	5.4	1.4	1.3	32.3	40.8	17.0	13.3
Indonesia	2.9	2.4	0.5	1.0	29.0	20.3	8.4	6.4
China	5.7	3.7	1.5	1.8	49.5	40.3	16.3	9.8
Malaysia	7.7	3.2	1.6	0.6	10.6	13.0	9.2	7.4
Singapore	0.4	0.1	0.1	0.0	0.3	0.4	0.4	0.0
Hong Kong	0.5	0.4	0.3	0.0	0.0	0.0	0.0	0.0

*Source:* Wan (2008, 255).

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<sup>51</sup> Trade liberalization refers to "a process by which a government reduces its intervention in trade by lowering tariffs or simplifying trade regulations and takes more of a neutral stance, favoring neither exports nor imports" (Wan 2008, 254)

#### **3.3.1.4 The Economic Openness-Welfare Nexus**

In general, “market-conforming” economies liberalize their domestic markets so that foreign investors can play an active role, especially in capital markets. In this case, national policy autonomy is greatly constrained by shareholders who search for short-term profits of business (Strange 1996; Scharpf 2000). When FDI and portfolio investment are substantial, both inside and outside pressures bearing down upon the government constrain the range of available policy choices (Drezner 2001; Keohand and Nye 1978). Welfare spending is also regarded as a fiscal burden that cannot be sustained in the competitive global market and, consequently, the governments tend to emphasize the self-help principle in constructing a national social security system.<sup>52</sup> In other words, liberalization fosters a market-conforming financial system that is “institutionally congruent” with individual savings-based social protection. The provident fund schemes of Singapore, Hong Kong, and Malaysia are examples of this approach.

By contrast, “market-distorting” economies are not as much vulnerable to the interests of shareholders as their “market-conforming” counterparts, because firms usually rely on government-linked bank loans or foreign borrowings rather than foreign investment as a main method to fund their growth strategy. This approach enables governments to maintain policy autonomy that is required for the protection of domestic industries from foreign competition (Kim 2002, 401). That is, the ability of the government to form long-term commitments to state-led development strategy depends on the availability of “patient” and “far-sighted” capital (Burgoon 2001; Estevez-Abe et al. 2001). Bank loans and foreign borrowings meet this

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<sup>52</sup> Based on earlier seminal works by Cameron (1978) and Katzenstein (1985), scholars like Garrett (1998) and Rodrik (1997; 1998) argue that the welfare state continues to provide substantial social protection benefits and compensation to those who lose from global market competition. Drawing on international trade theory (Hecksher-Ohlin models), Rogowski (1989) argues that the welfare state impact of economic globalization depends on variation in trade exposure and relative factor endowments.

condition. They are relatively “patient” and “less liquid,” so investments can be long-term oriented. In other words, financial intermediaries like banks enable the government and firms to establish a long-term development strategy without a great concern over short-run fluctuations in the capital market (Ebbinghaus and Manow 2001; Iversen 2005). The government’s concern is rather how to articulate cooperative links between industries and banks and how to protect skilled labor required for the success of state-led industrialization (Huber and Stephens 2001). To protect “core” workers in the formal sector from social contingencies, contribution-based risk-pooling is adopted as a stable and cost-effective method (Estevez-Ave 2001; Goodman and Peng 1996, 207; Wibbles and Ahlquist 2011, 127-128). As a result, those with a “market-distorting” system tend to develop social insurance programs as the institutional backbone of social protection. In sum, a long-term economic growth strategy requires “patient” capital and which in turn leads to the construction of IPW system to protect skilled labors.

### **3.3.2 Political Pressure and the Divergence**

I have explained above why “market-distorting” economies and “market-conforming” economies adopt substantially different social security schemes. While the former espouse a more inclusive social protection system primarily based on social insurance, the latter have a more market-oriented social protection system focusing on compulsory individual savings. However, we should remember that, although marketing-distorting economies launch various *inclusive* programs, the benefits are far from universal in the beginning. In general, a limited number of formal sector workers, who are considered central to economic growth, receive social insurance benefits. But, as seen in the cases of Korea and Taiwan, IPW benefits spill over to other categories of the population over time, magnifying the institutional differences between IPW and

MPW over time. If economic factors explain the initiation of the divergence of PWC, what factors drive the *growth* of the divergence (Pierson 2004, 3)?

### 3.3.2.1 Democracy-Welfare Nexus

In general, due to political pressure arising from the demand for social protection, policy makers in democratic regimes tend to allocate greater government revenue to social welfare than their authoritarian counterparts do (Adsera and Boix 2002; Kaufman and Segura-Ubiergo 2001; Rudra and Haggard 2001). Of course, nondemocratic regimes also adopt inclusive welfare measures. For example, during the 1970s and 1980s, the authoritarian state in Korea and Taiwan implemented a series of social security schemes as part of economic development strategies.<sup>53</sup> But a substantial *expansion* of such inclusive programs does not take place just for economic objectives. It requires political conditions that prompt policy makers to have commitment.

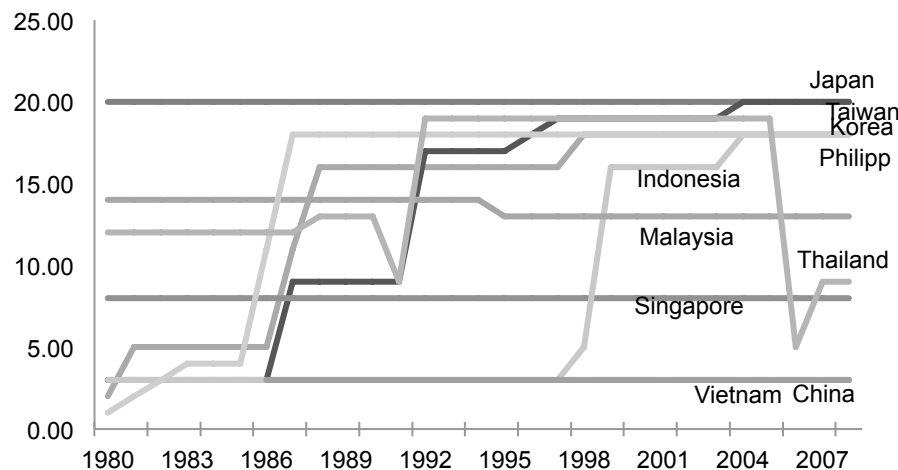
Democratic transition is one of the most conceivable political conditions because, in semi-democratic or authoritarian societies, citizens' political participation is limited and there are few opportunities to voice policy concerns. In contrast, democratic societies in which political leaders strive to survive electoral competition have greater incentives to be more responsive to the needs of the general population. In addition, while the costs of *adoption* of inclusive social security schemes for selected employees are quite modest even to authoritarian states (Gallagher and Hanson 2009), the *extension* of population coverage and entitlement of those schemes requires much more financial and political responsibilities than authoritarian leaders would be willing to bear. Hence, significant growth of IPW can hardly occur in authoritarian productivist

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<sup>53</sup> While the majority of social policies were adopted by democracies in Europe and North America, more than 70 percent of countries in other regions were autocracies at the time of adoption of those policies (Mares and Carnes 2009, 97).

welfare states. The experiences of Japan, Korea, and Taiwan are good examples as to how and why political pressure in democracy is crucial to the growth of IPW (Tang 2000, 60).<sup>54</sup> Gough (2004, 201) attempts to extend this explanation to Southeast Asian states as well, arguing that “Korea and Taiwan both witnessed democratic contestation in 1987, and the result was a significant shift towards state responsibility in social welfare in the 1990s... It is not too optimistic to expect similar transformation in Southeast Asia.”

Not surprisingly, the index of democratic governance that illustrates the contrasting feature between democratic countries and non-democratic regimes confirms that most IPW states have a high level of democratic rules while MPW states have a lower level (Figure 9). While Japan, Taiwan, Korea have developed democratic institutions up to almost the highest level (20), Singapore, Malaysia, Thailand, and transition economies have been staying at a lower level of democratic governance ranging from 3 to 10.



**Figure 9.** The Level of Democratic Governance in East Asia

Source: Polity IV Database (<http://www.cidcm.umd.edu/inscr/polity/index.htm>).

<sup>54</sup> A detailed case study on Korea, a representative example of IPW, is presented in Chapter 4.

More specifically, democratic transition and corresponding increases of political pressure influence the variation of PWC by changing (i) the policy context and (ii) the state-society relationship. First, democratization changes the policy context, expanding ideas and allowing actors to participate in policy processes previously dominated by the state. Second, it also gives rise to a change in the relationship between the state and its citizens from control to accountability. These two aspects are examined, in turn, in the following.

### **3.3.2.2 Changes in the Policy Context**

Democratic policy-making involves not only those from the state sector but also various actors of the society. They may have different interests and thus would like to pursue goals other than those set by the government. Although most citizens in East Asia still believe that economic growth is the most important goal of the state, democratization gives rise to changes in their attitude to the state's policy-making process (Dalton and Shin 2006). This is why the combination of productivist belief and democratic changes results in the extension of population coverage of social insurances programs in East Asia. Wong's (2004) study of health policy in Korea and Taiwan provides a good example as to how the impact of democratization has altered agenda setting, interests and idea formation, and actors and networks involved in policy-making processes. That is, the new openness of political setting leads the government to reflect not only the voice of economic policy bureaucrats but also the demands of social policy branches (Yang 2000). This is the most significant difference between authoritarian PWC and democratized PWC in the policy context (Ku 2009, 149).



### 3.3.2.3 Changes in the State-Society Relationship

Democratization also alters the vertical relationship between the state and the society by providing the people with more powers. The old-fashioned top-down power relationship is no longer a dominant form of governance in democratized productivist welfare states in East Asia. Instead, election emerges as an important mechanism that determines the legitimacy of governance. To win and retain office, politicians get to have a stronger commitment to inclusive welfare measures in the political market (Segura-Ubiergo 2007, 38). On the demand side, democracy provides citizens with more extensive and open channels of participation so that those who have remained uncovered can demand social benefits more strongly. On the supply side, democracy provides politicians with strong incentives to compete for votes. The change in rules of the game makes politicians dependent on popular vote, so in democratized productivist welfare states, political leaders are sensitive to not only economic growth but also people's demands for social protection. Even conservative parties use social programs for wide electoral appeals (Haggard and Kaufman 2008).

For example, the onset of democratization in the 1980s in Korea and Taiwan facilitated the process of political realignment and the expansion of social insurance programs. In Korea, voluntary health insurance was first introduced in 1963 and then made compulsory in 1976. Yet the scope of coverage was limited to only those workers employed large firms.<sup>55</sup> In a similar way, the Kuomintang (KMT) government in Taiwan first introduced a limited labor insurance program—which included medical care—in 1953. In both places, the process of democratization and the subsequent introduction of national elections during the 1980s shaped the course of social policy reform, compelling ruling parties to expand the scope of social insurance coverage.

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<sup>55</sup> By the early 1980s, less than one-fifth of workers benefited from any medical insurance coverage.

In Korea, the ruling party extended health insurance to farmers and workers in informal sectors in 1988 and 1989 to garner votes in presidential and legislative elections (Peng and Wong 2010, 662). It was also during this time that the government introduced the National Pension Scheme (NPS) to appeal to labor. The KMT in Taiwan reacted to democratization in a similar way. The ruling party initiated reform discussions during the late 1980s and legislated a comprehensive national health insurance (NHI) system in 1994. The NHI was implemented in the spring of 1995, on the eve of a presidential election. In Korea and Taiwan, democratic reform and the political incentives of electoral competition prompted the universalization of social insurance schemes that were introduced as part of productivist efforts.

Particularly, it is quite remarkable that, despite the adverse effects of the 1997 economic crisis, Korea's Kim Dae-Jung government (1998-2002) made an impressive inclusive welfare drive that would have been unrealistic in nondemocratic settings. Expansion of civil society and the proliferation of nongovernmental organizations, which are key products of democracy, placed political pressure upon the Kim government to enhance social security provision to protect those who are vulnerable or unemployed. For instance, Korea's inclusive measures were largely a reflection of proposals by the People's Solidarity for Participatory Democracy, one of the most outspoken liberal organizations in Korea (Moon and Yang 2002, 153). This explanation is applicable even to Japan, the most firmly established democracies in the region. During the 1990s, the end of conservative Liberal Democratic Party (LDP)'s one-party dominant rule in Japan caused political realignments, creating openings for policy innovations and allowing new civil society groups to enter the policy-making process (Peng and Wong 2010, 661).

Thus, before the wave of democratization began in the late 1980s, most East Asian IPW states provided social security benefits to only a few of the population, leaving vulnerable

sections of the population such as unskilled workers and farmers outside the system. But democratization has placed political leaders under pressure and made them to be more attentive to the constituents' demands. As such, the consolidation of democratic governance is a political condition under which IPW benefits are extended to more people.

#### **3.3.2.4 The Rise of “Critical Citizens”**

As explained above, it is obvious that no democratic government is completely immune to the provision of social protection, though with varying degrees of commitment to the provision. While this argument is reasonable, it focuses on the supply side (the state) of the political market. To gain a more comprehensive understanding, we need to examine the demand side (i.e., citizens' political attitudes) too.

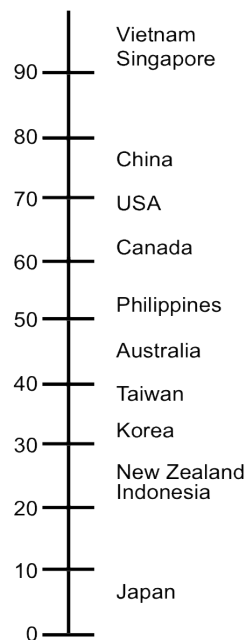
In general, democratic transition brings about changes in citizens' expectation of government, leading to the development of “critical citizens” or “dissatisfied democrats.”<sup>56</sup> It is widely observed that newly democratized regimes experience the growth of critical citizens who get dissatisfied with the performance of their representative government (Norris 1999). It is because economic growth and democratization tend to produce a public that becomes less deferential to authority and more engaged in various protest actions with a higher expectation of government. Particularly, in times of economic crises or social change, people feel insecure and are likely to challenge leaders and have a more demanding standard for politics, which in turn makes the position of governing elites more vulnerable (Inglehard 1997, 9).

Recent longitudinal studies in Japan and Korea confirm this assumption, showing a decline of political trust over the past decades (Ahn and Kang 2002; Shin and Rose 1998; Tanaka

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<sup>56</sup> The so-called dissatisfied democrat indicates an individual who supports democracy but is not satisfied with his/her regime (Burnell and Youngs 2010, 101-102).

2001). Other survey data also demonstrate that the level of political trust and satisfaction is largely higher in many nondemocratic states including Singapore and China (Inglehart and Welzel 2005; Wang 2005). For example, the 1999-2000 WVS survey data, which is about satisfaction with national politicians, shows that the least democratic nations reveal a strikingly higher level of regime support (Figure 10). By contrast, Japan, the oldest democracy in East Asia, has only 8 percent of the public who are satisfied with the government. Another study using the Gallup Millennium Survey also highlights that it is those highly democratic countries such as Japan and South Korea that are given low scores of political trust (Inoguchi 2000, 4-5). Not surprisingly, the East Asian Barometer and some other survey datasets commonly found that support for the government is lower in Japan, Korea, and Taiwan than in nondemocratic nations like China in the region (Tang 2005; Wang, Dalton, and Shin 2006, 142-143).



**Figure 10.** Satisfaction with National Politicians (% of respondents)

*Source:* 1999-2002 WVS (Wang, Dalton, and Shin 2006, 143)

Of course, the higher level of political trust is not necessarily a sign of true political support for the autocratic state. Maybe it is a result of the hesitancy to express opposition publicly. However, these findings indicate at least that authoritarian regimes are less vulnerable to political pressure than their democratic counterparts and, accordingly, democracies are more likely to use inclusive methods of social protection to appeal to the people for political support. For instance, Singapore and Malaysia where the vast majority of the population describe their semi-authoritarian government as just, respectful, and responsive have less resistance and pressure with regard to the commodification of social welfare. In democratic Japan, Korean and Taiwan where support for government institutions is lower, policy makers tend to engage in the extension of coverage of inclusive social security programs. In short, different political orientations of the people produce different impacts on the productivist approach to welfare capitalism, thus widening the gap between IPW and MPW.<sup>57</sup>

### **3.4 EMPIRICAL TEST: CROSS-SECTIONAL TIME-SERIES ANALYSIS**

What causes institutional variation of PWC? What leads productivist welfare states to be more inclusive or more market-oriented? As argued earlier, do the impacts of economic openness and

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<sup>57</sup> What is noteworthy here is that, in productivist welfare states where the perception on the government is substantially fragmented across regions (or sectors) in the country, both IPW and MPW strategies can be employed at the same time in a fragmented manner. In China, for example, urban state-sector workers who lost their jobs and welfare benefits during state-owned enterprise (SOE) reform in the 1990s staged mass protests to highlight the broken promises of the Communist Party. As one of the methods to deal with growing dissatisfaction among urban workers, the Chinese government has developed inclusive measures like the national pension program in urban areas. But those benefits are rarely provided in rural areas where a few of workers and virtually none of farmers are actively involved in job-related protests (Wright 2010). As such, the regional fragmentation of political attitudes among the people can breed a dualist policy response. A case study on China in Chapter 4 will further analyze the impact of fragmented political attitudes on DPW.

political pressures associated with regime type drive the divergence of PWC? In the remainder of this chapter, I conduct cross-sectional time-series analysis to test my argument as to the impact of economic openness and political pressure on IPW and MPW. The main hypotheses are as following:<sup>58</sup>

H1: Economic openness has a negative impact on IPW whereas it is positively related to MPW in East Asia, all else being equal.

H2: Productivist welfare states with a higher level of political pressure on policy makers are more likely to expand IPW than those with a lower level of political pressure.

### 3.4.1 Variables

The goal of this research is to clarify economic and political conditions under which productivist welfare states show different trajectories of social security institution. For this purpose, this chapter includes two dependent variables. The first is *IPW*, and the second is *MPW*. To measure these dependent variables, I am going to use the IPW index and the MPW index that have been used in Chapter 2. Again, the IPW index is derived from (i) the comprehensiveness of national pension and health insurance programs (in terms of eligibility and population coverage) and (ii) government expenditures on social security and health. The MPW index is generated based on the development of compulsory individual-savings schemes (in terms of eligibility and

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<sup>58</sup> Because this test focuses on the extent to which productivist welfare states become inclusive or market-oriented, I will examine the dualist issue separately in a case study of China in Chapter 4.

population coverage) and the rate of private health expenditure. See Chapter 2 for further information about these indices.

As the first independent variable, I use *economic openness*, comprising *trade openness* and *financial openness*. Economic openness is a variable to evaluate the effect of exposure to international markets on the institutional divergence of PWC. Following conventional practices in most of the literature on globalization, *trade openness* is measured as total trade—exports and imports—as a percent of GDP in current prices. Because this measure can be affected by the size of the economy, I include country dummies and GDP variables in the analysis as a method to control the economic size effect. For *financial openness*, I use gross private capital flows measured as the absolute values of direct, portfolio, and other investment inflows and outflows that are recorded in the balance of payments financial account.<sup>59</sup> This indicator is calculated as a ratio to GDP in U.S. dollars.

The second independent variable is *bottom-up political pressure*. Because the level of political pressure is generally higher in democratic regimes where electoral competition is open and significant, I use regime type—either democracy or autocracy—as a proxy for political pressure.<sup>60</sup> Indeed, the level of political pressures among the people tends to be higher in democracies than non-democracies in East Asia, as seen in many survey outcomes. Just as many other studies that use a dummy variable for regime type (e.g., Avelino, Brown, and Hunter 2005; Rudra 2008; Segura-Ubiergo 2007), I also use a dummy variable for the political regime, coding

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<sup>59</sup> Many studies estimate financial openness based on Quinn's (1997) measure of capital account regulation because the level of "regulation" is believed to be more refined than others in that it registers the intensity with which countries actively place financial restrictions on their capital accounts (Avelino et al. 2005, 630). However, we need to go beyond policy-based or regulation-based measures of financial liberalization, because the actual movement of capital varies depending on international economic environment while regulations do not reflect the impact of economic globalization in a timely fashion. Hence, I use the actual amount of capital flows for the analysis.

<sup>60</sup> Segura-Ubiergo (2007, 40) defines democracy as a regime (i) that sponsors free and fair competitive elections for the legislature and executive; (ii) that allows for inclusive adult citizenship; (iii) that protects civil liberties and political rights; and (iv) in which the elected governments really govern and the military is under civilian control.

1 for democracy and 0 for the residual category of authoritarian regimes. For this variable, I use Marshall and Jaggers' Polity IV data.<sup>61</sup> But, because this data is based on a continuous measure ranging from -10 for “most authoritarian” to 10 for “most democratic,” I label countries in question with 5 and above as “democratic” and countries below 5 as “nondemocratic.”<sup>62</sup>

**Table 10.** Description of the Main Variables

	Obs	Mean	Std. Dev.	Min	Max
IPW	235	24.19	19.96	1.65	62.30
MPW	218	32.52	23.00	5.45	86.77
Trade Openness	302	121.97	106.22	16.11	456.94
Financial Openness	187	22.44	31.37	1.21	175.57
Democracy	319	0.40	0.49	0	1

Alongside the key variables of interest, I also include several control variables, widely used in comparative welfare studies—*GDP* (size of the economy), *GDP growth rate* (economic growth), *urbanization*, *change in unemployment rate* (economic shocks), *population* (country size), and *percent of the population over 65* (demographic characteristic). Data for these variables are taken from the Asian Development Bank's *Key Indicators*, the IMF's *Government Finance Statistics*, the World Bank's *World Development Indicators*, Polity IV, supplemented with various domestic statistical yearbooks. Appendix 2 provides a description of the variables, the sources of the data, and the measurement scale.

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<sup>61</sup> <http://www.systemicpeace.org/polity/polity4.htm>

<sup>62</sup> Yet, sometimes it is not that easy to distinguish between democratic and nondemocratic regimes. It is because, while states like Japan, Korea, and Taiwan are fully democratic, semi-democratic states like Singapore and Malaysia have some democratic elements such as competitive elections. In order to ensure the validity of my results, I have run the regression with the continuous variable too. Using the continuous variable, however, had no substantive impact on the results.



### **3.4.2 Analytical Method and Model Specification**

The analysis includes 11 East Asian states: Japan, South Korea, Taiwan, the Philippines, China, Thailand, Indonesia, Vietnam, Hong Kong, Singapore, and Malaysia. With the sample period of 1980-2008, the data form a cross-sectional time-series (CSTS) set in which each country-year represents a single observation. The full data matrix, accordingly, comprises a maximum of 319 observations (11 countries by 29 years). However, some countries in the sample have relatively weak statistical agencies and, hence, limitations to the availability of the data are inevitable. Due to the problem of missing data, this chapter's analysis includes only about 180 observations. To overcome this kind of data availability problem, many studies often fill out missing data with the means of the relevant variables for each country for all available years. Wibbels and Ahlquist's study (2011) is one of the examples. This type of the treatment of missing data has an advantage that enables to make use of all available data and thus estimates parameters on the maximum sample size. This is often used to fix the problems caused in surveys and census data (Howell 2007). However, in a CSTS dataset, this method can produce a bias in the parameter, raising a question of validity and reliability. Hence, I choose to include in the analysis the original 180 observations rather than filling out missing slots

To test the hypotheses, I run a cross-sectional time-series (CSTS) regression analysis that combines a comparison of countries and a time series analysis. CSTS helps increase the number of observations and obtain more reliable estimators. Furthermore, since CSTS analysis does not rely on a single time point, it allows us to trace temporal patterns as well. Despite the great benefits of a pooled dataset, however, the spatial and temporal properties of CSTS make the use of Ordinary Least Squares (OLS) problematic. It is because it can violate at least two of the basic assumptions of OLS estimation (Hicks 1994). First, the cross-sectional structure of the data

increases the chance of *heteroskedasticity* that the variance in the error terms may be unequal across countries and that there will be spatial processes that affect different panels simultaneously. Second, the temporal structure of the data increases the chance of *autocorrelation* that the errors are correlated each other between different units at the same point in time. The presence of heteroskedasticity and autocorrelation does not bias the regression coefficients dramatically but tends to lower the size of the standard errors and artificially increases the significance of the estimated coefficients (Gujarati 2004, 442). To address these possible problems, Beck and Katz (1995) recommend two methods: (i) using OLS estimation with a lagged dependent variable to correct for the serial correlation; and (ii) replacing the OLS standard errors with panel-corrected standard errors (PCSE).

In this analysis, I follow Beck and Katz's second suggestion, using PCSE to deal with the error term issue. The PCSE method is useful especially when the number of time period is larger than the number of cases. However, regarding the first suggestion, I choose a different method instead of using a lagged variable to address the autocorrelation problem. Although many works use a lagged dependent variable to deal with autocorrelation, this method is not effective if variables do not vary substantially over time (Avelino et al. 2005, 629). Moreover, because the lagged dependent variable is the most significant explanatory factor in general, the correlation between the variables is inevitably very high, making almost all the other variables insignificant. So there may be not much about the role of economic and political factors that are of important theoretical interest. Achen (2000) demonstrates that a lagged dependent variable "does bias the substantive coefficients toward negligible values and does artificially inflate the effect of the lagged dependent variable." As such, the use of lagged dependent variable erodes the effect of the other independent variables while it does not markedly contribute to the explanation. Also,

the very interpretation of the lagged dependent variable is problematic. The high correlation between the two dependent variables is a result of the fact that both share a range of causes such as economic, political, demographic, and historical factors (Huber and Stephens 2001). Hence it is not justified to interpret the lagged dependent variable as a measure of path dependency or persistency.

Perhaps the best way to test the substantive theoretical propositions outlined earlier is to transform the data—which is called the Prais-Winsten estimation technique (Greene 1990; Achen 2000). This method allows us to correct for the serial correlation while avoiding the pitfalls of using the lagged dependent variable. Plümper, Troeger, and Manow (2005) advocate the use of the Prais-Winsten transformation with PCSE as an estimation procedure that tests substantive theoretical expectations more accurately than any other models that employ lagged dependent variables. Following this suggestion, I use a baseline model as follows:

$$\begin{aligned}
 IPW_{it} \text{ (and } MPW_{it}) = & \alpha_i + b_t + \beta_1 \text{ Trade}_{i,t-1} \\
 & + \beta_2 \text{ Capital}_{i,t-1} \\
 & + \beta_3 \text{ Democracy}_{i,t-1} \\
 & + \beta_4 \text{ Trade}_{i,t-1} * \text{Democracy}_{i,t-1} \\
 & + \beta_5 \text{ Capital}_{i,t-1} * \text{Democracy}_{i,t-1} \\
 & + \sum (\beta_j \text{ Controls}_{i,t-1}) \\
 & + e_{i,t-1}
 \end{aligned}$$

In this equation, the terms  $\alpha$  and  $b$  stand for country and year dummies. The  $\beta$ 's are the parameter estimates, and  $e$  denotes the error term. The subscripts  $i$  and  $t$  indicate the country and year of observations, respectively. *IPW* and *MPW* represent the level of “inclusiveness” and

“market-orientation” of productivist welfare institutions in question. *Trade* and *capital*, representing trade openness and financial openness, describe the level of exposure to international markets. *Democracy* is a proxy of political pressure, measured as regime type (either democratic or nondemocratic). To examine how the effect of economic openness varies when political pressure increases, the model includes interaction terms between *trade* and *democracy* and between *capital* and *democracy*. The independent variables and the control variables are lagged in order to account for the period of adjustments. As Rodrik (1997) suggests, it is theoretically sensible to anticipate a lagged effect on the ground that economic and political changes take time to affect policy outcomes.

### **3.4.3 Analysis Results**

Do economic openness and political pressure drive productivist welfare states into a more inclusive way or a more market-oriented way? The results presented in this section indicate that levels of IPW and MPW are significantly affected by economic and political variables, but that the direction and intensity of the effects are somewhat mixed.

The regressions yield four important findings: (a) the impact of economic openness, involving trade and capital flows, is negatively associated with IPW; (b) democracy is always positively related to IPW, yet its interaction effect show a somewhat mixed picture; (c) as the economy becomes increasingly integrated with the global trade and capital markets, the degree of MPW becomes higher; and (d) political pressure in democratic regimes does not come into play significantly in reducing MPW, and its interaction effect is also neither consistent nor statistically significant. In short, democracy and IPW mutually reinforcing while the liberalization of the economy is positively associated with MPW.

### **3.4.3.1 Inclusive Productivist Welfare**

Table 11 presents the results of a set of regressions that look into the determinants of the institutional development of IPW in East Asia. Model (1) and (2) estimate the effects of economic liberalization and regime type on the development of IPW. As discussed in the previous section, many studies of international political economy predict that economic globalization has a negative relationship with welfare state development whereas it has a positive relationship with democracy. Model (1) and (2) support these conventional approaches. The results suggest that productivist welfare states with a high level of trade and capital flows tend to have a lower level of IPW. Trade has a negative impact on the expansion of insurance-based schemes and government expenditures on welfare programs consistently and significantly. The results also confirm that market-oriented financial activities are negatively associated with inclusive institutions of productivist welfare. These findings indicate that economic liberalization is a critical determinant of inclusive measures of PWC in East Asia.

Next, the coefficients of regime type in Model (1) and (2) are roughly 3.7, which means that democratic productivist welfare states apparently promote more social insurance programs and spend more on social welfare than their nondemocratic counterparts. The positive relationship between democracy and IPW appears statistically significant and consistent, implying that political pressure in democratic regimes indeed matters regardless of other control variables.

**Table 11.** Regression Results for Inclusive Productivist Welfare (IPW)

	(1)		(2)		(3)		(4)	
	<i>b</i>	PCSE	<i>b</i>	PCSE	<i>b</i>	PCSE	<i>b</i>	PCSE
Trade <sub>t-1</sub>	-.068***	.008	-.064***	.013	-.071***	.008	-.057***	.013
Capital <sub>t-1</sub>	-.006	.010	-.036**	.018	-.001	.010	-.043**	.018
Democracy <sub>t-1</sub>	3.766**	1.649	3.730**	1.642	23.499***	3.145	6.325	4.589
Trade <sub>t-1</sub> *Democracy <sub>t-1</sub>					-.191***	.021	-.033	.036
Capital <sub>t-1</sub> *Democracy <sub>t-1</sub>					.279**	.116	.200	.092
GDP <sub>t-1</sub>			.006***	.001			.006***	.001
GDP per capita <sub>t-1</sub>			-.001***	.000			-.001**	.000
GDP Growth <sub>t-1</sub>			.054	.072			.067	.082
Urbanization <sub>t-1</sub>			.088	.065			.059	.064
Δ Unemployment <sub>t-1</sub>			-.086	.283			-.085	.314
Inflation <sub>t-1</sub>			.051	.066			.022	.079
Δ Exchange Rate <sub>t-1</sub>			.014	.013			.023	.017
Population (65+) <sub>t-1</sub>			2.248***	.346			1.737***	.298
Population <sub>t-1</sub>			-.013***	.002			-.012***	.002
Constant	29.756***	.826	13.628***	3.676	31.264***	2.299	16.035***	3.623
Observations	179		178		179		178	
Prob > Chi <sup>2</sup>	.000		.000		.000		.000	
R <sup>2</sup>	.274		.617		.795		.616	

Note: \* p<0.1 \*\* p<0.05 \*\*\* p<0.01

However, the picture changes when the conditional effects of trade openness and financial openness are modeled with an interaction term between democracy and these openness variables. Many studies claim that, because economic globalization brings about more uncertainty and volatility and consequently a higher demand for social protection, democratic states facilitate an upward shift of welfare benefits (Garrett 1998; Kittel and Winner 2005; Rieger and Leibfried 2003; Rodrik 1997). Model (3) and Model (4) show that this argument is true in East Asia but only partially.

### **Model (3)**

$$\begin{aligned} IPW_{i,t} = & 31.26 - 0.07 \text{ trade}_{i,t-1} - 0.001 \text{ capital}_{i,t-1} + 23.50 \text{ democracy}_{i,t-1} \\ & - 0.191 \text{ trade}_{i,t-1} * \text{democracy}_{i,t-1} + 0.279 \text{ capital}_{i,t-1} * \text{democracy}_{i,t-1} + e_{i,t-1} \end{aligned}$$

$$\text{If democracy (=1): } IPW_{i,t} = 54.76 - 0.26 \text{ trade}_{i,t-1} + 0.28 \text{ capital}_{i,t-1} + e_{i,t-1}$$

$$\text{If nondemocracy (=0): } IPW_{i,t} = 31.26 - 0.07 \text{ trade}_{i,t-1} - 0.001 \text{ capital}_{i,t-1} + e_{i,t-1}$$

### **Model (4)**

$$\begin{aligned} IPW_{i,t} = & 16.04 - 0.06 \text{ trade}_{i,t-1} - 0.04 \text{ capital}_{i,t-1} + 6.33 \text{ democracy}_{i,t-1} \\ & - 0.03 \text{ trade}_{i,t-1} * \text{democracy}_{i,t-1} + 0.20 \text{ capital}_{i,t-1} * \text{democracy}_{i,t-1} \\ & + \Sigma(\beta_j \text{ Controls}_{i,t-1}) + e_{i,t-1} \end{aligned}$$

$$\begin{aligned} \text{If democracy (=1): } IPW_{i,t} = & 22.36 - 0.09 \text{ trade}_{i,t-1} + 0.16 \text{ capital}_{i,t-1} + \Sigma(\beta_j \text{ Controls}_{i,t-1}) \\ & + e_{i,t-1} \end{aligned}$$

$$\begin{aligned} \text{If nondemocracy (=0): } IPW_{i,t} = & 16.04 - 0.06 \text{ trade}_{i,t-1} - 0.04 \text{ capital}_{i,t-1} + \Sigma(\beta_j \text{ Controls}_{i,t-1}) \\ & + e_{i,t-1} \end{aligned}$$

Let us interpret the coefficients for Model (3) and (4), starting with the constants first. The values of the intercept for trade openness and financial openness regressed on IPW for democracies and nondemocracies are 54.76 and 31.26 respectively in Model (3) and 22.36 and 16.04 in Model (4). These substantial gaps signify that democratic regimes have a higher level of IPW constantly, if other conditions are equal. Second, in Model (3), the coefficient for trade openness among democratic regimes is -0.26, which is somewhat lower than that of nondemocratic regimes (-0.07). The coefficients for Model (4) reveal the same pattern, with -0.09 in democratic nations and -0.06 in nondemocratic states. These outcomes suggest that trade liberalization has a

significant reductive effect on IPW regardless of regime type. Yet, democratic countries are more negatively influenced by trade openness than their authoritarian counterparts are.

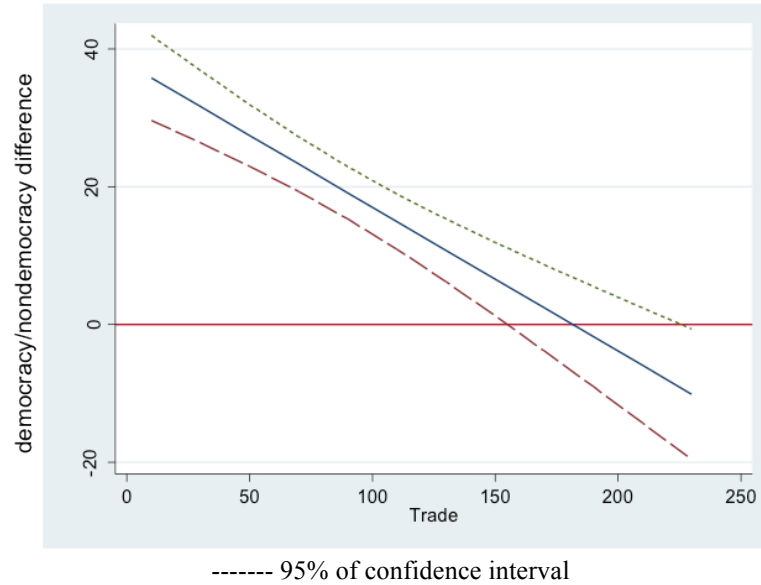
However, this picture is reversed in the case of financial openness. In Model (3), the coefficient for financial openness is 0.28 in democratic states and -0.001 in nondemocratic regimes. The coefficients in Model (4) are 0.16 for democracies and -0.04 for nondemocracies. This result exhibits a “compensation effect” that democratic regimes tend to expand IPW as their financial markets become more liberalized. By contrast, nondemocratic states are likely to reduce inclusive welfare programs as financial openness increases. From this, we can conclude that, while trade openness has the “race-to-the bottom” (RTB) effect on IPW regardless of regime type, the impact of financial openness on IPW is different depending on whether the state is democratic or nondemocratic.

Figure 11 and 12 facilitate the interpretation of the above results, graphically illustrating how differences between democratic and nondemocratic regimes in their IPW levels change at different values of economic openness.<sup>63</sup> 95 percent confidence intervals around the line show that, when the upper and lower boundaries of the confidence interval are above or below the zero line, the effects are supposed to be statistically significant.

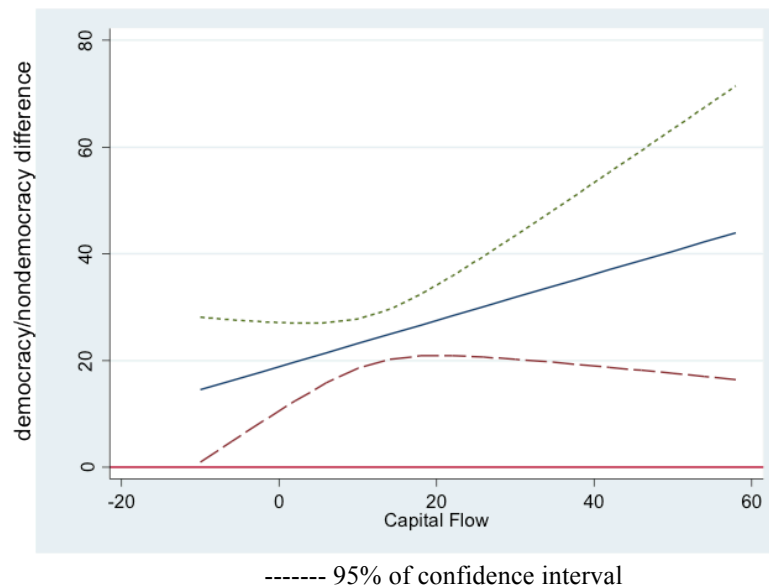
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<sup>63</sup> The graphs are drawn based on Model (3).





**Figure 11.** Marginal Effect of Democracy on IPW at Different Levels of Trade Openness



**Figure 12.** Marginal Effect of Democracy on IPW at Different Levels of Financial Openness

As seen in Figure 11, differences between democratic and nondemocratic states in terms of IPW decrease as the value of trade openness increases. This result is statistically significant at the

95% confidence level when the overall amount of trade, measured as a percent of GDP, is less than 150. This means that, although democratic regimes show a higher level of IPW, the democracy effect reduces gradually as trade becomes more liberalized.

In contrast, Figure 12 shows that the democracy effect increases in the case of capital liberalization. As capital markets become more liberalized, democratic states are more likely to strengthen IPW than their authoritarian counterparts are. In other words, there is a strong “compensation” effect that is believed to be prevalent amongst democratic regimes. This trend is statistically significant at almost all levels of international capital flows that are calculated as a ratio to GDP.

### **3.4.3.2 Market Productivist Welfare**

We now turn to ask whether increasing exposure to international markets translates into MPW, consistent with my theoretical expectations. First, as expected, Table 12 provides strong evidence that trade openness has had a consistently positive effect on MPW in models both with and without control variables. The coefficients of trade openness are 0.19 and 0.23 in Model (5) and Model (6), respectively. These results are statistically significant and exactly what this study has intended to find.

However, the second variable displays a different picture. Everything else being equal, an increase in capital flows is associated with a decrease—rather than increase—of MPW. The coefficients are  $-0.13$  in Model (5) and  $-0.02$  in Model (6). Yet, while the outcome in Model (5) is statistically significant, the inclusion of control variables gets rid of this statistical significance in Model (6). From these results, we may conclude that trade plays a more salient role in influencing MPW than capital flows do.

Then, what about the impact of political pressure on MPW? Table 12 reveals that the magnitude of the democracy effect on MPW is neither strong nor consistent. The coefficient is – 0.1 in Model (5) while it is 0.14 in Model (6). Thus, the causal directions are mixed and also statistically insignificant, which leads us to conclude that democracy is neither consistently nor robustly correlated with MPW.

**Table 12.** Regression Results for Market Productivist Welfare (MPW)

	(5)		(6)		(7)		(8)	
	<i>b</i>	PCSE	<i>b</i>	PCSE	<i>b</i>	PCSE	<i>b</i>	PCSE
Trade <sub>t-1</sub>	.189***	.019	.227***	.016	.168***	.019	.237***	.021
Capital <sub>t-1</sub>	-.134**	.068	-.015	.038	-.114*	.061	-.023	.041
Democracy <sub>t-1</sub>	-.097	1.363	.138	1.472	-11.195***	2.819	-1.208	3.448
Trade <sub>t-1</sub> *Democracy <sub>t-1</sub>					.096***	.022	.011	.029
Capital <sub>t-1</sub> *Democracy <sub>t-1</sub>					.055	.094	.043	.087
GDP <sub>t-1</sub>			.014***	.003			.014***	.003
GDP per capita <sub>t-1</sub>			-.001***	.000			-.002**	.000
GDP Growth <sub>t-1</sub>			-.141	.089			-.111	.092
Urbanization <sub>t-1</sub>			.082	.065			.137*	.080
Δ Unemployment <sub>t-1</sub>			-.310	.211			-.336	.233
Inflation <sub>t-1</sub>			-.148**	.073			-.152**	.077
Δ Exchange Rate <sub>t-1</sub>			-.016	.018			-.015	.020
Population (65+) <sub>t-1</sub>			-3.749***	.688			-1.483***	.407
Population <sub>t-1</sub>			.001	.004			-.001	.004
Constant	12.352***	.826	29.262***	5.184	14.805***	2.507	14.196***	3.748
Observations	179		178		179		178	
Prob > Chi <sup>2</sup>	.000		.000		.000		.000	
R <sup>2</sup>	.817		.833		.695		.785	

Note: \* p<0.1 \*\* p<0.05 \*\*\* p<0.01

What happens if an interaction term between regime type and economic openness is included in the models? As for trade openness, the estimates indicate that, when a country's overall trade increases, the level of MPW also increases regardless of regime type. Model (7) below shows that the coefficients are positive for both democratic and nondemocratic regimes—0.26 and 0.17

respectively. That is, popular political pressure that is usually stronger in democratic regimes and so supposed to play a more significant role in reducing market-oriented social programs does not actually work that way. Rather, democratic states that used to have a lower level of MPW are likely to expand MPW measures slightly more than their nondemocratic counterparts as their trade openness increases. That is, the RTB theory appears more appropriate to explain the positive statistical relationship between trade and MPW in both democratic and nondemocratic productivist welfare states in East Asia.

### **Model (7)**

$$\text{MPW}_{i,t} = 14.81 + 0.17 \text{ trade}_{i,t-1} - 0.11 \text{ capital}_{i,t-1} - 11.20 \text{ democracy}_{i,t-1} \\ + 0.10 \text{ trade}_{i,t-1} * \text{democracy}_{i,t-1} + 0.06 \text{ capital}_{i,t-1} * \text{democracy}_{i,t-1} + e_{i,t-1}$$

$$\text{If democracy (=1):} \quad \text{MPW}_{i,t} = 3.61 + 0.26 \text{ trade}_{i,t-1} - 0.06 \text{ capital}_{i,t-1} + e_{i,t-1}$$

$$\text{If nondemocracy (=0):} \quad \text{MPW}_{i,t} = 14.81 + 0.17 \text{ trade}_{i,t-1} - 0.11 \text{ capital}_{i,t-1} + e_{i,t-1}$$

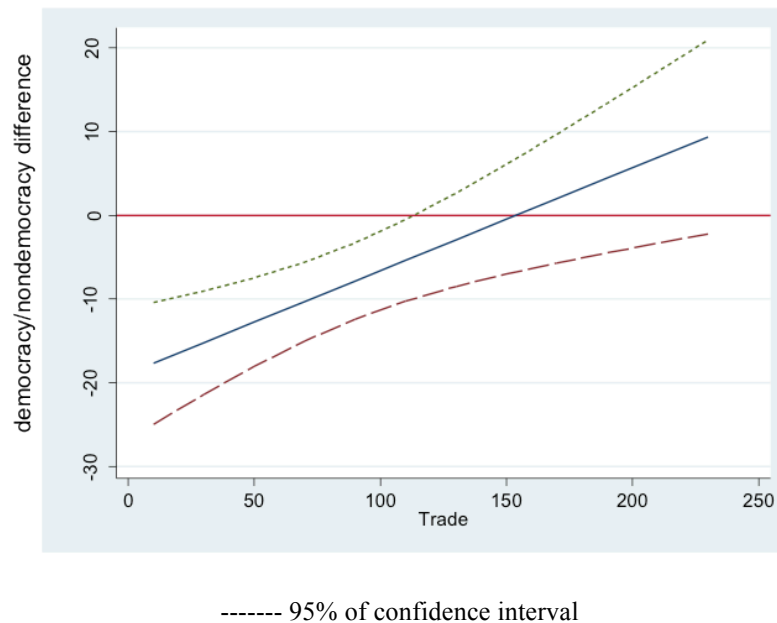
### **Model (8)**

$$\text{MPW}_{i,t} = 14.20 + 0.24 \text{ trade}_{i,t-1} - 0.02 \text{ capital}_{i,t-1} - 1.21 \text{ democracy}_{i,t-1} \\ + 0.01 \text{ trade}_{i,t-1} * \text{democracy}_{i,t-1} + 0.04 \text{ capital}_{i,t-1} * \text{democracy}_{i,t-1} \\ + \Sigma(\beta_j \text{ Controls}_{i,t-1}) + e_{i,t-1}$$

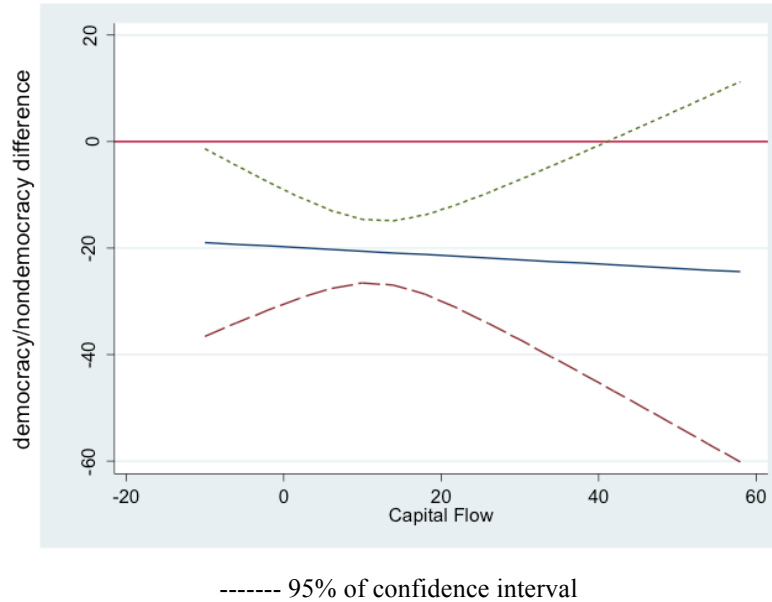
$$\text{If democracy (=1):} \quad \text{MPW}_{i,t} = 12.99 + 0.25 \text{ trade}_{i,t-1} + 0.02 \text{ capital}_{i,t-1} + \Sigma(\beta_j \text{ Controls}_{i,t-1}) \\ + e_{i,t-1}$$

$$\text{If nondemocracy (=0):} \quad \text{MPW}_{i,t} = 14.20 + 0.24 \text{ trade}_{i,t-1} - 0.02 \text{ capital}_{i,t-1} + \Sigma(\beta_j \text{ Controls}_{i,t-1}) \\ + e_{i,t-1}$$

Another finding presented in Model (7) is that financial openness is not positively related to MPW. Also, there is no strong interaction effect between regime type and financial openness. In other words, MPW is not greatly influenced by the value of financial openness in both democratic and nondemocratic states. This result is reversed, though, when we consider control variables. Model (8) indicates that democratic states are likely to expand MPW measures as international capital flows increase, whereas nondemocratic productivist regimes tend to slow down MPW. However, this outcome has no robust ground to believe that it is statistically reliable.



**Figure 13.** Marginal Effect of Democracy on MPW at Different Levels of Trade Openness



**Figure 14.** Marginal Effect of Democracy on MPW at Different Levels of Financial Openness

Figure 13 and 14 illustrate the above findings graphically, showing how the marginal effect of regime type changes at different levels of trade openness and financial openness.<sup>64</sup> In general, the MPW level in democracies is lower than that of nondemocracies. However, the gap between democracies and nondemocracies becomes narrower as the overall level of trade openness increases. This trend is statistically significant when exports and imports range from 0 to 110 percent of GDP. In contrast to the findings on trade openness, however, the interactive effect between regime type and financial openness is not statistically meaningful to merit further discussion.

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<sup>64</sup> The graphs are drawn based on Model (7).

### 3.5 CONCLUDING REMARKS

Why do some productivist welfare states enter the pathway to inclusive social welfare programs while some others expand market-oriented social policy programs? Under what conditions are social insurance-based measures (IPW) and individual savings-based schemes (MPW) abounding? The large literature that deals with welfare state development (and retrenchment) has relatively neglected to examine the causal mechanism underlying PWC in East Asia. So this chapter has analyzed the birth and growth of institutional variation in productivist welfarism, investigating two causal links that relate economic openness and political pressure to the divergence.

The main arguments are based on the assumption that productivist welfarism has been derived from economic considerations and therefore any divergence of productivist welfare institution is an outcome of changes in the economic and political circumstances under which PWC had been able to develop. Based upon this viewpoint, I have presented my arguments in two steps. First, I have related institutional variations in PWC to differences in economic strategies pursued by East Asian states, particularly focusing on the impact of trade and foreign capital on the divergence. This economic explanation is useful as an effort to find the “first-order” causal variable that spells out the initial divergence of productivist welfare regime. Then, I have turned to the nature of political regime as the second factor that is believed to have further widened the gap between IPW and MPW.

Regarding these economic and political factors, I present the following hypotheses. First, economic openness has a negative impact on IPW whereas it is positively related to MPW in East Asia, all else being equal. Second, productivist welfare states with a higher level of political pressure on decision makers are more likely to expand IPW than those with a lower level of

political pressure. These hypotheses are to test whether the causal foundations of the “race-to-the-bottom” (RTB) theory and the “compensation” theory exist among productivist welfare states in East Asia.

The results of the regression analysis indicate that, first, the impact of economic openness is indeed more likely to increase IPW. Second, the nature of democratic regime is also positively related to IPW, yet its interaction effect shows a somewhat mixed picture. As trade increases, both democratic and nondemocratic regimes tend to reduce IPW—which provides support for the RTB theory. However, when capital flows increase, democratic regimes are likely to expand IPW while nondemocracies reduce inclusive welfare programs. This is evidence that democracy matters in the age of economic globalization. Third, regarding MPW, regression analysis shows that increasing volumes of global trade are positively related to the growth of MPW while the role of capital flows is relatively insignificant. Finally, the impact of democracy on MPW is neither consistent nor statistically significant in influencing MPW levels.

Overall, the findings in this chapter indicate that democratic productivist welfare states are more likely to expand social insurance-based inclusive measures and that economic globalization—especially trade openness—has the power to compel productivist welfare state to develop individual savings-based social security programs. This empirical analysis makes a meaningful contribution to the understanding of East Asian welfare regimes, thus providing a bird’s eye view that allows for general assessment of the relationship between causes and effects of PWC. However, it is obvious that quantification of the attributes of PWC and its divergence cannot cover all details of how PWC has evolved. This is particularly true in the case of DPW that takes dualist pathways integrating IPW and MPW simultaneously. For this reason, we cannot underestimate the value of qualitative case studies that lies in the ability to address this



type of tough questions. Hence, the next chapter will scrutinize three cases of Korea's IPW, Singapore' MPW, and China' DPW, bringing us to a further understanding of how the statistical results can be interpreted in particular settings.

## **4.0 THREE CASES OF PRODUCTIVIST WELFARE CAPITALISM**

### **4.1 INTRODUCTION**

The early generation of the East Asian NIEs—Japan, Korea, Taiwan, Hong Kong, and Singapore—has been a favored topic of comparative political economy over the last several decades. This is not a surprise if one considers the distinctiveness of their path to economic growth. The distinctiveness has been termed the “developmental state,” the essence of which is the foremost and single-minded priority of state policy in economic development (Woo-Cumings 1999). Within this developmental paradigm, a strong commitment to “protective” social welfare is regarded as inefficient and wasteful. This is why East Asian developmental states have laid down institutional foundations of productivist welfare capitalism (PWC) since the early stage of industrialization.

At first glance, the combination of productivism and social protection may look enigmatic because social protection is not what is logically expected in the productivist paradigm. As explained in the previous chapters, however, the primary goal of social protection in the East Asian productivist context is not the promotion of social rights per se but rather the promotion of economic productivity. For this reason, East Asia’s social policy development is considered distinctive as much as its remarkable economic growth. Indeed, during the industrialization period, social welfare provisions such as pension, health, unemployment, and

education were largely subordinated to the imperatives of labor production, human capital accumulation, and rapid economic growth. In particular, this productivist strategy has been widely used as part of nation-building efforts since Japan established the prototype of PWC during the late 19<sup>th</sup> century Meiji Restoration (Haggard and Kaufman 2008, 114-115; Goodman and Peng 1996).

Yet, East Asia's pathways toward PWC are not uniform. As proved in Chapter 2, institutional features of PWC have evolved toward more inclusive (risk-pooling via social insurance) or more market-oriented (self-reliance via individual savings) directions. To explain institutional variation in PWC, I have offered two major independent variables in Chapter 3. The first is economic liberalization—the extent to which productivist welfare states are exposed to global trade and capital markets. The second relates to the extent of bottom-up political pressure embedded in democratic regimes in general. The statistical results largely support my hypotheses, indicating that economic openness—especially trade—is closely associated with market productivist welfare (MPW) while democracy tends to foster inclusive productivist welfare (IPW) although the interaction effect of democracy is not very strong statistically. The findings from the quantitative analyses show us a general trend regarding the institutional divergence of PWC. However, quantitative approaches are not sufficient to grasp a richer and more nuanced understanding of how economic and political factors have shaped different patterns of PWC.

This chapter therefore explores three exemplary cases that provide a closer look at the impact of economic and political factors on the institutional divergence of PWC. The cases include Korea's inclusive approach (IPW), Singapore's market-oriented strategy (MPW), and China's dualist way (DPW). For each case, I will first survey the institutional features of social

protection programs, mainly focusing on their old-age pension and healthcare schemes. The second half of each case examines political and economic conditions under which Korea, Singapore, and China have evolved into three types of PWC.

The reason why I focus on pension and healthcare in this chapter is that these two programs are believed to be essential to the understanding of social policy patterns of risk-pooling and self-reliance, because the economic impact and associated interests of pension and health programs are enormous compared to other welfare provisions (Hwang 2006, 133). In particular, China's dualist approach is examined in this chapter with equal weight as the other two. Since the quantitative analysis of Chapter 3 mainly investigated the linear relationship between IPW and MPW, this chapter covers qualitative features—which is more useful for understanding China's dualist strategy.

## **4.2 KOREA**

Productivist welfare programs in Korea have been developed with the need of cultivating a workforce that was believed to further economic development. In the 1960s and 1970s, the Korean government began to increase public support for education and provided social security benefits for state employees and industrial workers. The overriding concern, however, was not only how to protect strategic human resources for economic growth but also how to minimize the financial burden of the state. To address this puzzle, the Korean government created a limited IPW system in which a significant portion of financial responsibilities was transferred to companies and families. Firms—especially big manufacturing industries—were not reluctant to provide the company-sponsored risk-pooling benefits to their workforce because they needed to

secure a stable supply of skilled workers (Kwon and Lee 2011, 115). As such, a combined contribution of firms and employees became the major funding source for IPW in Korea. Based on this policy initiative, several compulsory social insurance programs were created, without any significant expansion of public spending on general welfare. During the industrialization period, the productivist welfare state in Korea thus focused less on the provision of comprehensive “protective” benefits, limiting its role to the regulatory function.

However, it was demonstrated in 1997—when the Asian financial crisis shook the Korean economy severely—that the limited IPW programs were neither sufficient nor effective in keeping the general public from unprecedented socioeconomic blow. As part of efforts to overcome the crisis, the Korean government started to further extend the existing IPW benefits to almost the entire population including those who would have otherwise been left outside the social protection system. As a result, the population coverage rates of the national pension scheme, national health insurance, and unemployment insurance have remarkably increased since the late 1990s.

Due to this substantial expansion of social insurance programs, Korea is often viewed as if it has been transformed into a social democratic type of welfare state (Kim 2002). But in fact the motivation of the IPW expansion was to minimize any possible adverse effects that might result from structural adjustment policies in the wake of the economic crisis (Kwon and Holliday 2007: 245-247). Indeed, even after the remarkable extension of population coverage, the primary principle of social policy has remained in line with the promotion of economic growth (Haggard 2008: 250). That is, changes in economic circumstances—e.g., the rise of financial liberalization—have not fundamentally altered the essential character of Korea’s productivist

welfarism but rather have propelled the expansion of IPW benefits as a buffer to absorb negative impacts of the foreseeable increase of labor market flexibility.

This section discusses the continuity and change of IPW in Korea, exploring how they are associated with changes in economic and political circumstances. Particularly, it explains that “marker-distorting” economic strategy created limited IPW in Korea, and that political pressure coupled with periodic electoral competitions served as a main catalyst for the expansion of IPW. Indeed, the transition to democracy has greatly facilitated the development of IPW in Korea (Song and Hong 2005).<sup>65</sup>

#### **4.2.1 Development of the Inclusive Productivist Welfare Capitalism**

##### **4.2.1.1 Pension Insurance System**

The history of the public pension insurance system goes back almost 50 years to 1960 when the Government Employees Pension (GEP) system was established. Soon after the adoption of GEP, the Korean military regime set up two special pension schemes for military personnel in 1963 and then for private school teachers in 1975. Meanwhile, a national pension program for private-sector employees was proposed in 1972 by the Korea Development Institute (KDI)—a government think-tank of the Economic Planning Board (EPB)—that was established with the goal of enhancing economic plans for industrialization.

Considering social development as part of economic policy, the KDI began to engage with social policy making from 1972 and proposed an idea that social policy would be able to

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<sup>65</sup> Of course, the authoritarian Korean state employed IPW as one of the methods to garner political support to overcome its lack of constitutional legitimacy. However, the establishment of pension and health insurance programs was mainly for civil servants, military personnel, public school teachers, and industrial workers who were viewed as critical for the regime’s survival. It was not until the 1987 democratization movement that the government began to substantially expand social security programs.

facilitate economic growth within the given economic policy paradigm. Because in the 1970s the government made an important change in its grand economic strategy from export-led industrialization coupled with import-substitution to heavy-chemical industry, it was required to mobilize a substantial amount of national resources and domestic capital. The KDI proposed to use national pension as a means of capital mobilization to fund the heavy-chemical industrialization drive of the Park Chung-Hee regime (Yang 2000, 104). As a former researcher of the KDI pointed out in an interview, the role of the KDI in designing social welfare programs was always centered on economic development (Hwang 2006, 57).

Although the government initially supported the proposal, however, the implementation of national pension was suspended indefinitely because of the first oil shock in 1973 followed by the worldwide recession and high inflation. It was not until 1986 that the proposal was reintroduced to the government. Even though the proposal returned after about 15 years, the National Pension Act of 1986 was almost identical to its predecessor with only minor changes. One of those changes was that the 1986 proposal covered all workplaces that hired 10 or more employees whereas the 1973 plan aimed to limit the coverage to firms with more than 30 employees. The 1986 proposal seemed at first glance to be quite inclusive in terms of population coverage. But in reality it covered only 32 percent of the economically active (and relatively well-off) population (Table 13).

**Table 13.** Coverage of Public Pensions in Korea, 1980-2010

Unit: 1,000 persons

	[1] Employed population aged 18 & over	All public pension contributors				[2] / [1] (%)
		National pension	Gov't employee pension	Private school teacher pension	[2] Total	
1980	13,150	-	648	89	738	5.6
1985	14,667	-	697	124	821	5.6
1988	16,728	4,433	767	141	5,341	31.9
1990	17,983	4,652	843	154	5,649	31.4
1991	18,566	4,769	885	159	5,812	31.3
1992	18,939	5,021	922	165	6,109	32.3
1993	19,181	5,160	940	171	6,271	32.7
1994	19,799	5,445	948	175	6,568	33.2
1995	20,365	7,497	958	181	8,636	42.4
1996	20,810	7,829	971	192	8,993	43.2
1997	21,165	7,836	982	203	9,021	42.6
1998	19,895	7,126	952	206	8,285	41.6
1999	20,246	16,262	914	208	17,383	85.9
2000	21,116	16,210	909	211	17,330	82.1
2001	21,542	16,278	913	216	17,407	80.8
2002	22,144	16,499	931	221	17,651	79.7
2003	22,114	17,182	948	225	18,355	83.0
2004	22,529	17,070	965	230	18,265	81.1
2005	22,832	17,124	986	237	18,348	80.4
2006	23,124	17,740	1,009	246	18,995	82.1
2007	23,399	18,267	1,022	251	19,539	83.5
2008	23,558	18,335	1,030	257	19,623	83.3
2009	23,484	18,624	1,048	262	19,933	84.9
2010	23,801	19,229	1,052	267	20,549	86.3

*Note:* Excludes military pension contributors.*Source:* National Statistical Office (2011), Table 10-5.

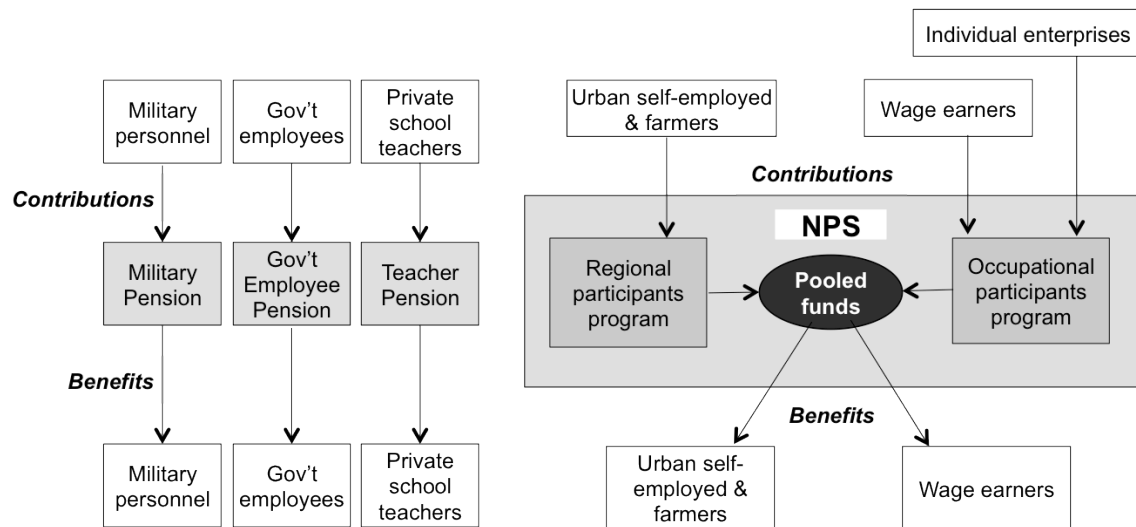
The newly proposed national pension scheme (NPS) was finally implemented in 1988, covering employees in firms with more than 10, which was about 4.4 million workers (Table 13). During the Roh Tae-Woo presidency (1988-1992), the number increased to over 5 million workers covering all firms with 5 or more employees. In 1995, President Kim Young-Sam (1993-1997)



extended the program to the self-employed in rural areas because pension coverage expansion was one of his presidential electoral pledges (Yang 2004, 197). As a result, the NPS grew once again covering an additional 3 million people in the private sector during the mid-1990s. And over the years, the coverage has been extended continuously. In particular, the coverage of the NPS increased remarkably in 1999 as it was extended to all employees in the private sector and the urban self-employed, which was almost 86% of the whole employed workforce. This significant coverage extension was mainly due to the 1997 Asian financial crisis that devastated the Korean economy. In the wake of the crisis, the Kim Dae-Jung government (1998-2002) developed several social welfare programs including the NPS as a compensation for neoliberal structural adjustment to overcome economic difficulties (Yang 2004, 1999). Since then, the government has been striving to raise the coverage rate to 100 percent. Thus, a new era of “universal” pensions began in Korea, in which most workers and self-employed people were covered by a single unified national pension scheme, just except for the government employees, military personnel, and private school teachers who were covered by separate programs (Figure 15).<sup>66</sup>

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<sup>66</sup> A further explanation of economic and political conditions for the coverage expansion will be provided in the next section.



**Figure 15.** Pension Insurance System in Korea

When the pension plan was introduced in 1986, one of the major purposes was the government's investment of the accumulated fund in the public sector and economic development programs.<sup>67</sup> For this purpose, the EPB formulated the Fiscal Investment and Financing Special Account Act that allowed government ministries such as the Ministry of Construction and Transportation to be able to use the NPS funds at lower interest rates. This arbitrary use was taken as granted from the very beginning in spite of considerable concern about the accountability and sustainability. As a consequence, the use of the NPS fund in public sector reached more than 70 percent in 1998 (Hwang 2006, 74-75). The discretionary operation of the NPS funds that were solely financed through the contributions of employees and employers was highly prevalent during the 1980s and 1990s. This is an example demonstrating how the Korean government used social policy as a policy tool for the economy.

<sup>67</sup> The government expected almost \$ 5 billion in the fund for the first year of the NPS (Hwang 2006, 74).

But the problem was not only the diversion of the fund. The NPS has often been criticized for its low contribution and high benefits structure that exacerbated the sustainability problem over time. The contribution rate of the NPS was initially 3 percent until 1992 and increased to 6 percent until 1998, shared evenly between employees and their employers. Compared to that of other welfare states, 6 percent was too low to sustain the system financially. Table 14 shows that the contribution rates of European welfare states, for example, were about 16 to 18 percent as of 1998—three times larger than Korea’s contribution rate. Moreover, the high benefit level made the financial sustainability more unlikely in Korea. As seen in Table 14, the average final income replacement rate was as high as 70 percent, and this full pension benefit was available on reaching just 60 years of age (after 20 years of contribution).<sup>68</sup> Given the nature of productivist welfarism, this generous benefit was truly unrealistic. Obviously, the Korea government was not very much serious about political accountability and financial sustainability when it designed the NPS.

**Table 14.** The Low Contribution and High Benefits Structure of the NPS

as of 1998

Country	Germany	France	Sweden	Japan	Korea
Contribution rate (%)	18.6	16.35	20.3	16.5	6
Income replacement rate (%)	60	50	60	69	70
Retirement age (male-female)	65-60	60-60	65-65	60-59	60-60

*Source:* Yang (2004, 197)

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<sup>68</sup> The eligibility will be raised to 61 years in 2013 and eventually to 65 years by 2033. The partial pension benefit is available if making contributions for 10 to 19 years. Those who contribute for less than 10 years receive the accumulated amount plus interest as a lump sum (Ramesh 2004, 54).

In fact, the KDI had been already aware of the problem from the very beginning of the program. It anticipated that the fund would be exhausted before 2040 (Kwon 2002). Indeed, the financial sustainability problem which was attributed to the inherent structural weakness of the system became urgent before long, and the government had to decide whether to subsidize the pension fund, whether to raise the level of contributions, whether to decrease the benefit level, and whether to raise the pensionable age. Because massive government subsidies would negatively affect its budget, the Kim Dae-Jung government (1998-2002) proposed to reform the NPS law to increase the retirement age to 65 and reduce the benefit level by 10 percent. Based upon the reform proposal, the Kim government adjusted the overall level of benefits down to 60 percent and increased the contribution rate to 9 percent in 1999 while continuing to extend the coverage to a wider population.

In sum, the NPS underwent three stages: initiation (1973), implementation (1988), and reform (1998). At the initiation stage, the very design of the NPS was greatly influenced by economic bureaucrats who guided the policy paradigm of economic development. Social protection was simply subject to economic strategies, particularly for the vested political interest of the military regime. The risk-pooling effect of national pension was believed to bring several advantages to the regime politically and economically by providing a large sum of accumulated funds. This expectation was materialized when the NPS was implemented in 1988. Because political leaders believed that the NPS would not only promote the economy but also help win the first democratic presidential election (as examined in the next section), the government launched an unrealistic structure of the NPS with low contributions and high benefits. But the sustainability problem arose when the 1997 financial crisis smashed the Korean economy and, as a response, the Kim Dae-Jung government embarked the first major reform of the NPS.

#### 4.2.1.2 Health Insurance System

The Park Chung-Hee regime enacted the Health Insurance Act in 1963 soon after the military *coup d'état* of 1961. In designing pilot programs, particular preference was given to a social insurance scheme that aimed to benefit industrial workers first. At the same time, those programs were designed in a way to enhance the development of the national economy without budget increases, which was believed most suitable to Korea. Based on this belief, a health insurance bill was passed, allowing only the voluntary participation of employees who worked in firms with over 300 employees. This voluntary system remained almost intact until 1976.

The government revised the Health Insurance Act substantially in 1976, integrating the principle of mandatory participation and universality. In practice, however, the principle of mandatory participation was applied only to employees (and their dependents) who work in large firms with more than 500 workers. That is, the Act provided privileged insurance benefits to large-firm workers while retaining the voluntary principle to workers in smaller firms and the self-employed (Hwang 2006, 88). Among the latter group of people, those who wanted to join the insurance program had to pay a higher rate of premium. Because health insurance was seen as a means to protect large-firm workers who were expected to lead the national economy (mainly in heavy-chemical industries), most non-members and voluntary members were discriminated more than the mandatory insurance members in the system. As such, national health insurance (NHI) was primarily for workers in large corporations who could afford to pay premiums.

Yet, health insurance was gradually extended in 1979, benefiting workers in firms with 300 employees. Later it was further extended to cover workers who were employed in firms hiring 100 employees in 1981, 16 employees in 1983, and then much smaller workplaces hiring

more than 5 workers in 1988. The Korean government also began to extend health insurance to the self-employed in the early 1980s.

The extension of health insurance benefits to the self-employed was to deal with the widening gap between the insured employed and the uninsured self-employed. Because the health insurance system reimbursed care providers based on a regulated fee schedule, the providers charged higher fees to the uninsured. The unfair practice of regulated fees and unregulated fees caused discontent among the uninsured, which could significantly undermine political legitimacy of the authoritarian regime (Kwon 2009, 65). Due to this political concern, the health insurance program underwent a series of extension and finally became universal in 1989, benefiting the self-employed in rural and urban areas.<sup>69</sup> As a consequence, almost 94 percent of the population could have public health insurance in 1990, and the percentage further reached 99 in 2008 (Table 15).

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<sup>69</sup> Only daily wage earners with less than one month of continuous employment and the unemployment were excluded from health insurance. They were eligible for Medicaid, a means-tested public assistance program (Ramesh 2004, 92).

**Table 15.** Population Coverage of Health Insurance in Korea, 1980-2008

Year	Coverage (1,000 persons)	Coverage (%)
1980	9,226	24.20
1985	17,995	44.10
1990	40,180	93.73
1995	44,016	97.61
1996	44,603	97.98
1997	44,925	97.76
1998	44,472	96.08
1999	45,184	96.93
2000	45,896	97.63
2001	46,379	97.94
2002	46,659	97.98
2003	47,103	98.42
2004	47,372	98.61
2005	47,392	98.45
2006	47,410	98.16
2007	47,820	98.69
2008	48,160	99.08

*Source:* NHIC (2010).

The adoption of compulsory health insurance and the inclusion of the self-employed in both rural and urban areas meant that health insurance became nationwide and available to almost all. However, another problem was that there was no unified national health insurance system in Korea. At each stage of the development of the NHI, many health insurance societies were created for different occupational and regional categories. Before all health insurance societies were merged in 2001, there had been three types of insurance schemes and societies. The first type was for government employees and private school teachers and their dependents, administered by a single insurance society. The second type was for industrial workers and their dependents, managed by about 140 insurance societies. The last type was for the self-employed

and workers in firms with less than 5 employees that was handled by about 230 insurance societies (Kwon 2009, 65). Although all these three types of health insurance societies were the members of the National Federation of Medical Insurance regulated by the Ministry of Health and Welfare, each insurance society was financially independent, managing their members in some autonomous ways with different rates of contributions and benefits. For example, before the merger of insurance societies in 2000, each of them set insurance premiums independently, varying between 2 and 8 percent of the monthly wage. The average contribution rate was 5.6 percent for government employees and school teachers and 3.75 percent for industrial workers with a range of 3 to 4.2 percent (Hwang 2006, 92). The increase in the number of insurance societies brought about an inequality problem among the insured across the country.

The regional fragmentation of health insurance also raised the similar problem of inequality and unfairness. Before the merge, the healthcare system had been divided into three regions, including (i) 138 medium-sized healthcare regions, (ii) 8 large healthcare regions, and (iii) one nationwide healthcare region. In this regional system, all the patients had to see medical doctors in their local clinics, except for certain medical conditions. Without a referral from their local family doctor, they could not get medical treatment in other regions. While urban residents benefited high-quality medical services even for primary care at relatively lower costs, rural residents had primary medical treatment (Choi 1996, 79).

This underlying problem of inequality and unfairness emerged as a serious political issue for the first time when health insurance became universal in 1989. As regional insurance members increased noticeably in both rural and urban areas, inequality between rural and urban residents became an important issue in upcoming elections. Recognizing the political

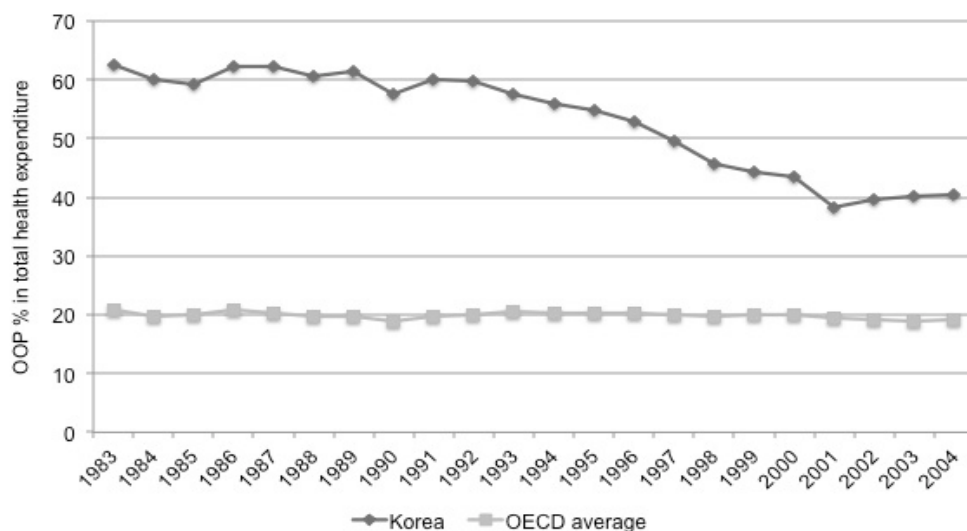


significance of the integration of healthcare system, the National Assembly passed a reform bill in 1989, calling for the merger of insurance regions and societies.

However, President Roh (1988-1992) vetoed the bill because the merger of the financial system for NHI would require a greater administrative role and substantial financial obligation of the government. As a semi-authoritarian regime, the Roh government could not overlook a sizeable increase in government social spending and any potential negative impact of the integration on the selectorate and winning coalition—mostly the high- and middle-income groups who were the main supporters of Roh's semi-authoritarian ruling party (Bueno de Mesquita et al. 2003). The unification of existing health insurance societies might also result in the loss of existing bureaucratic patterns that had bolstered the regime (Hwang 2006, 100). Thus, the presidential veto was seen as a strategic choice to minimize the government's financial imposition while protecting those with vested interests within the semi-authoritarian regime. Indeed, the system of multiple insurance societies was fit to the purpose of limited IPW—that is, the government could provide risk-pooling benefits to high- and middle-income households and industrial workers of big businesses more effectively at a lower cost.

But the limited IPW strategy could not be continued because of, among others, the financial vulnerability of the funds. The overall balance of health insurance funds was relatively stable until 1996. But in 1997 and after, the total health expenditure began to exceed the total revenue, causing a financial deficit. Since the financial structure of NHI was established based on low contributions, it was financially vulnerable from the outset just as the NPS was. The continued extension of medical benefits without an increase in the contribution rate imposed financial pressures subsequently on the government. Instead of increasing contribution rates, however, the government increased the co-payment rate as high as 55 percent for outpatient care

and 40 percent for inpatient care to solve the deficit problem. This approach simply made the patients responsible for a greater portion of the medical service fees (Shin 2003, 120). This is why the share of out-of-pocket (OOP) payments in total health expenditure went as high as 63 percent. Although the share has decreased to 38 percent since the mid-1990s, it is still much higher than the OECD average (Figure 16).



**Figure 16.** Share of Out-of-Pocket Payment in Total Health Expenditure

Source: OECD Health Data (<http://www.oecd.org/health/healthpoliciesanddata>)

Despite the adoption of universal health insurance system, the high rates of co-payment and OOP were a considerable barrier to medical services in Korea. Moreover, the economic crisis that hit the economy in 1997 added fuel to the vulnerability problem, making a huge number of people insolvent. The unemployment rate sharply increased, and real wages decline as much as 40 percent in the aftermath of the crisis. The unprecedented economic crisis simply revealed that the limited IPW system was unsound to be a measure to protect the general public from social risks.

In order to stabilize the health care system, it was necessary to raise contribution rates. But paying more contributions was neither economically feasible nor politically realistic due to the deteriorating economy.

Under such a condition, the integration of fragmented health insurance societies was almost the only choice on the table. It seemed be able to not only improve horizontal equity between various occupational categories but also achieve greater redistribution from the rich to the poor. But the unification would also demand a greater role of the government because the implementation of a unified system requires a shift of major decision-making about contributions and benefits from each insurance society to the government. The shift was also expected to cause the increase in government spending (Hwang 2006, 104).

The 1997 presidential election was a momentous event that led the new president to pursue a new policy on health insurance. When Kim Dae-Jung—a long-standing opposition leader advocating democracy and social solidarity—was elected as the new president in the midst of the economic crisis, he convened a committee to push ahead with the integration of health insurance societies and enacted a new law that would merge all the health funds into the NHI in 2000. Indeed, the 1997 economic crisis and the arrival of the Kim government gave rise to a significant change in the nature of Korea's PWC, leading policy makers to shift their focus from limited and unequal social insurance benefits to more comprehensive and realistic IPW schemes. However, the fundamental characteristic of productivist welfarism—i.e., the subordination of social policy to economic objectives—has remained essentially unchanged even in the Kim Dae-Jung government. The unification of health insurance was only part of wider attempts to boost labor market flexibility after the economic crisis (Kwon and Holliday 2007).

Until now, I have described how the Korean government created limited risk-pooling systems for old-age pension and health insurance and has unceasingly extended the insurance benefits to almost all people. Then what economic and political factors have driven Korea's productivist welfare programs from a limited inclusive path to a substantially inclusive direction? The next section examines political and economic contexts of the institutional development of Korea's IPW.

## **4.2.2 Political Economy of Korea's IPW**

### **4.2.2.1 Economic Contexts**

Following General Park Chung-Hee's military coup in 1961, Korea became an authoritarian state with brutal repression of dissent. While strengthening political power, the military government built a strong bureaucratic apparatus, such as the Economic Planning Board (EPB), and started to intervene in the development process with the five-year economic development plans since 1962. Because the military junta viewed economic performance as the most important source of legitimacy, rapid economic growth rose to prominence on the policy agenda (Kwon 1999, 20; Wade 1990). In this circumstance, the function of the EPB and other economic bureaucracies was focused on "the establishment of comprehensive plans for the development of the national economy and to manage and regulate the execution of the development plans" (Woo 2004, 36). Under the leading role of the EPB, Korea established growth targets with a special emphasis on (i) state-led industrialization via the protection of the domestic market and industries, (ii) nurturing big industrial conglomerates such as Samsung, Hyundai, LG, and Daewoo, (iii) providing privileges for export-oriented manufacturing companies, (iv) controlling banks and supplying the necessary capitals for industrialization through foreign loans, (v) promoting

technological development in domestic industry, and (vi) creating a high quality and low-cost labor force by controlling labor movements tightly (Holliday and Wilding 2003, 28; Wade 1992, 312).

Particularly noteworthy in the Korean developmental state is its financial institutions and the way to mobilize and allocate domestic and foreign capital. Among all of the economic development strategies implemented by the military junta, the most durable and significant was the control over the banking system (Woo 1991). Soon after the coup, the military government nationalized all commercial banks by confiscating wealth that was allegedly accumulated illegally. The nationalization of banks opened a way for the state's direct control over the banking system. For example, the Ministry of Finance took over the monetary policy authority out of the central bank, and the head of the central bank was placed under control of the president (Shin 2003, 57). The government also established the Korean Development Bank to (i) increase its capital base by borrowing from abroad, (ii) provide payment guarantees for foreign loans obtained by domestic firms, and (iii) supply long-term loans to government and state-owned enterprises (Cho and Kim 1995, 31).

In order to mobilize domestic capital for investment in industries, the government raised the interest rate remarkably from 15 percent up to 30 percent in 1965. The increase of interest rates was to provide a strong incentive for domestic savings. As domestic capital was accumulated significantly, the government allocated those savings to leading export industries with great benefits. The interest rate on export loan, for instance, was 6.1 percent during the period of 1966 to 1972, while the general loan interest rate was 23.2 percent on average (Shin 2003, 58). Despite the economic strategy to mobilize domestic capital, however, the overall amount of domestic savings was not sufficient to meet the need for investment in industries

(Amsden 1989, 74). So the government turned to look for foreign capital in the mid-1960s. Yet, unlike other East Asian NIEs—especially, Singapore and Hong Kong—that attempted to attract FDI, the Korean government focused on foreign borrowings to finance its investment plans.

Table 16 shows that foreign borrowing became the main source of foreign capital inflow in the mid-1960s. As the amount of foreign loan increased, the debt-asset ratio of most export-leading firms also became larger in Korea. Particularly, the credit-based financial system constructed by the government was a promising condition for the growth of heavy and chemical industries that required massive long-term investments. At the same time, the high rate of foreign loan, together with a tight control over credit systems and FDI, strengthened the government's power to control foreign capital flows and monitor firms' economic activities. To be sure, the direct intervention through “market-distorting” development strategies is one of the most idiosyncratic characteristics that distinguish the Korean development state from other “market-conforming” developmental states like Singapore and Hong Kong.

**Table 16.** Foreign Capital Inflows in Korea, 1961-1979

Year	Total (US\$ million)	Foreign Aid (%)	Foreign Loan (%)		FDI (%)
			Public Loan	Commercial Loan	
1961	208.1	99.4	0.6	.	.
1962	205.0	97.5	0.9	1.3	0.3
1963	273.1	75.9	14.7	7.5	1.9
1964	169.7	83.0	8.7	7.8	0.4
1965	186.7	72.0	2.7	22.3	3.0
1966	327.2	37.3	22.3	36.3	4.1
1967	371.7	36.1	28.5	33.4	2.0
1968	478.4	25.2	14.7	56.1	4.0
1969	744.2	13.9	28.7	55.2	2.2
1970	727.8	11.7	28.8	50.4	9.0
1971	755.5	8.4	40.2	45.7	5.7
1972	780.3	6.4	41.6	41.8	10.0
1973	891.3	3.9	41.3	38.6	16.0
1974	1,098.2	3.7	28.7	56.1	11.2
1975	1,397.0	3.4	34.5	57.6	4.4
1976	1,653.1	0.8	42.9	50.9	5.2
1977	1,980.4	0.4	30.7	63.6	5.2
1978	2,858.6	0.3	28.5	67.5	3.4
1979	2,845.2	0.3	38.1	56.9	4.4

Source: IMF, *International Financial Statistics*.

Korea's "market-distorting" approach also influenced the pattern of trade. Despite its strong support for exports, Korea's trade liberalization is not as significant as other East Asian NIEs. During the 1950s and early 1960s, Korea adopted a protectionist import-substitution (IS) strategy initially and then shifted to export-oriented industrialization (EOI). However, the Korean government was reluctant to liberalize imports while it was actively engaged in export-oriented strategies (e.g., the establishment of export-free zones). Table 17 illustrates that Korea's export-oriented strategy is based on the protectionist tactic. Even though Korea is one of the important global economies, its trade level is much lower (compared to Hong Kong and Singapore) while the tariff rates have remained higher.

**Table 17.** Trade and Tariffs in East Asian NIEs

	Trade (% GDP)				Mean Tariff Rates (%)			
	1980	1990	2000	2009	1980	1990	2000	2009
Korea	72.8	57.5	78.3	95.7	20.4	13.0	8.7	9.74
Taiwan	104.1	86.5	105.3	118.4 <sup>*</sup>	.	9.7	8.8	6.9 <sup>*</sup>
Hong Kong	178.3	252.6	282.1	380.5	0.0	0.0	0.0	0.0
Singapore	428.4	360.6	377.7	381.9	0.3	0.4	0.0	0.1

*Source:* Penn World Table 6.3; Wan (2008, 255).

*Note:* \* the value of 2004.

“Guided capitalism” that the government embarked on in 1962 continued to orchestrate the overall process of economic development in Korea. And the result was the dazzling speed of economic growth with rapid industrialization. For example, Korea was just 40<sup>th</sup> biggest exporter of manufactured goods to the U.S. in the early 1960s, but by 1986 it became the 5<sup>th</sup> largest exporter. Also, during the periods of the first and second five-year economic development plans (1962-66 and 1967-71), Korea achieved impressive GNP growth rates of 8.5 percent and 11.4 percent, respectively, which were higher than the original plan of 7 percent (Shin 2003, 56). Without doubt, the Park regime made it clear that economic development should be the supreme goal virtually equal to national security in importance, and that nothing else can replace it.

In this developmentalist environment, comprehensive social welfare was simply a luxury. Instead of the adoption of general social welfare programs, the Korean government concentrated public resources on education, which was believed as one of the most effective ways to promote



skills and train labor for industrialization (Rudra 2008, 143-146).<sup>70</sup> Recognizing the importance of the human capital, the Korean government viewed education as an integral part of economic development. Based on this notion, the government spent much larger amounts of resources on education than any other social policy areas with strict control over curriculum and administration of schools (Kim 2000).<sup>71</sup> Since the policy of compulsory public education was implemented in the late 1950s, the government has centralized control in the Ministry of Education to ensure universal access to primary and secondary education. Also, the EPB produced five-years plans for education, calling for the increase of enrollment in vocational institutions even up to 70 percent of all secondary education (Ramesh 2004, 162).<sup>72</sup> As such, education was central to Korea's PWC not only as social policy but as a measure to promote skilled workers.

Despite the underlying "economy-first" doctrine, however, the military government passed a series of social welfare laws in the early stage of military coup, including the Civil Servant Pension Law (1961), the Military Pension Law (1963), the Social Security Law (1963), the Industrial Accident Compensation Insurance Law (1963), and the Medical Insurance Law (1963). Since the economic situation in the late 1950s and early 1960s had not been improved immediately, General Park who was suffering from lack of political legitimacy considered welfare programs as another important means to gain public support, especially when he planned to run for the presidential election in 1963. So the Korean military regime enacted many social welfare laws in a short period, arguing that "we will make our best efforts to improve the quality

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<sup>70</sup> Education was also interpreted as a vehicle for transmitting hard-working values and group-oriented attitudes supportive of economic development (Morris 1996, 99).

<sup>71</sup> Refer to Table 1.

<sup>72</sup> In practice, the enrollment rate stayed under 50 percent, which was though still higher by international standards (Ramesh 2004, 162).

of ordinary people's living condition and establish the welfare society by the introduction of a social security system based on social insurance and social assistance programs that cover all of the Korean population" (Shin 2003, 62).

However, despite the initial declaration, only a few programs were put into effect, covering a small percentage of the population—mainly government employees, military personnel, and industrial workers in large firms who were believed to serve as the workforce to administer state policies and carry out economic development strategies (Kwon 1999, 51-52).<sup>73</sup> Even though Park Chung-Hee had initially considered various social benefits, he basically viewed social welfare as a poor instrument to combat poverty, on the belief that a successful economy is the most promising path toward national welfare, and that jobs are what poor nations need most (Song and Hong 2005, 180). Social welfare was not a priority to the government, and consequently, the benefits were not universalistic throughout the 1960s and 1970s. As such, limited social insurance benefits were a major segment of Korea's IPW together with education, and the benefits were restricted to industrial workers and employees in large firms, government employees, and military personnel. Because the goal of these initiatives was to promote and protect skilled labor without any increases in public financial burden, the Korean government launched contributory schemes as the institutional platform of its limited IPW.

Until the early 1990s, Korea's financial system and corporations remained tightly monitored by the government. The use of interest rate and credit targets was an effective policy tool to control the business sector. However, a question about the effectiveness of the government-controlled financial system was raised, as big business (*chaebol*) increasingly called

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<sup>73</sup> The pension scheme for the military personnel was implemented in 1963 and the Industrial Accident Compensation Insurance in 1964. Health insurance was introduced as a voluntary system in 1963 and then became compulsory at the national level in 1977.

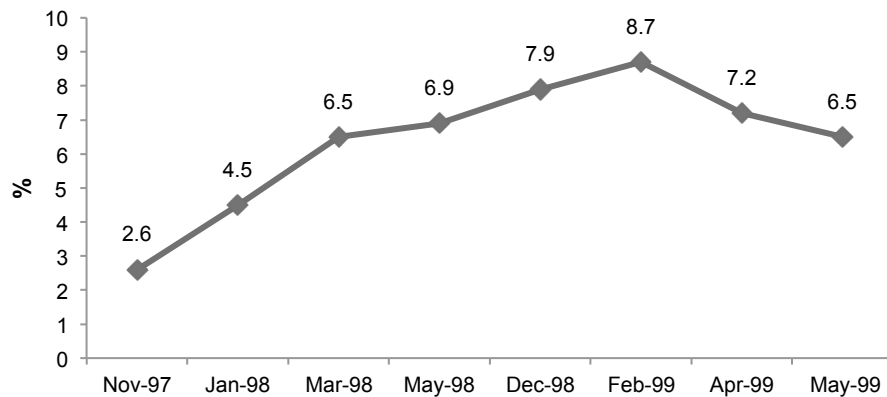
for the removal of government control over the credit system. Moreover, the U.S. began to strongly press Korea to liberalize the financial sector since the late 1980s (Stubbs 2005). As a response to these pressures, the Kim Young-Sam government (1993-1997) declared to launch a globalization (*seggyehwa*) policy, implementing financial liberalization. Particularly, the Kim government reduced its control over foreign borrowings. However the rapid liberalization produced serious problems because there was no following fundamental reform of the “market-distorting” banking system and “crony” corporate governance (Kang 2002). The liberalization measures carried out by the Kim government no longer required firms to obtain permission from the government for foreign borrowings and, as a result, the overall amount of foreign debt was remarkably increased from \$44 billion in 1993 to \$120 billion in 1997 (Shin 2003, 173). What was even worse was that the proportion of short-term debt in total foreign debt rose from 43.7 percent in 1993 to 58.3 percent in 1997. The inappropriate liberalization and wrong management of the banking system and financial institutions in the name of *seggyehwa* resulted in an unprecedented economic crisis in 1997 (Hamilton-Hart 2008).<sup>74</sup>

The devastating impact of the 1997 financial crisis was beyond imagination, especially regarding the sweeping increase of unemployment rates. As seen in Figure 17, the financial crisis transformed Korea in a short time from an economy with a stable labor market into an unstable economy associated with social instability. Before the crisis, the unemployment rate was merely 2.6 percent, but it soared to 8.7 percent in 1999. Facing this crushing economic crisis, the newly elected President Kim Dae-Jung implemented a series of social security reforms, including the integration of the health insurance societies into a unified system and the extension of the NPS

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<sup>74</sup> See Haggard (2000) for further information about the Asian financial crisis of 1997.

benefits to the self-employed. The government also expanded the Unemployment Insurance Scheme and the Industrial Accident Compensation Insurance Plan to all workplaces.



**Figure 17.** Unemployment Rates after the 1997 Financial Crisis

*Source:* Shin (2003, 180).

In short, Korea launched social insurance-based programs as part of the “market-distorting” development strategy, benefiting a limited number of workers during the 1960s, 1970s, and 1980s. However, the limited IPW coverage has extended over time to almost all the citizens as a policy measure to deal with changes in economic circumstances. Particularly, the development of Korea’s IPW was an outcome, coupled with the government’s efforts to alleviate social insecurities after the 1997 economic crisis. In addition to this economic background, however, we need to examine the impact of political factors as well in order to understand the development of Korea’s IPW.

#### 4.2.2.2 Political Contexts

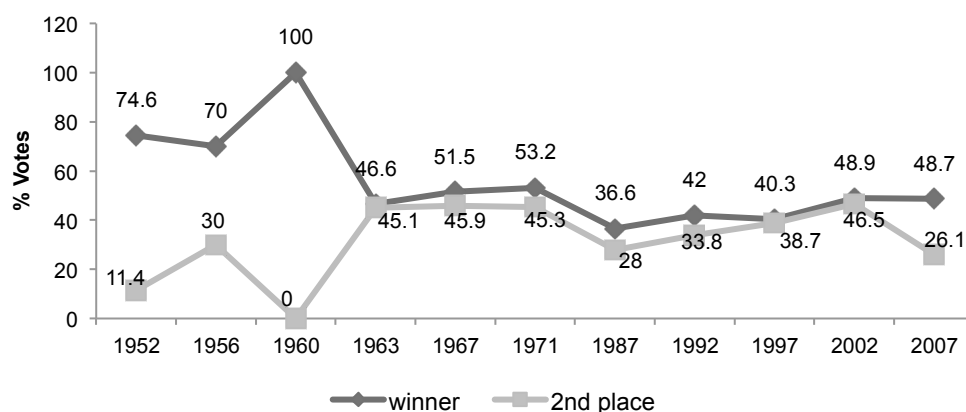
Soon after the military coup of 1961 and a period of military rule (1961-1963), Park Chung-Hee held presidential elections in 1963, 1967, and 1971 to stay in power as a “legitimate” president.<sup>75</sup> Despite a booming economy in the 1960s and 1970s, however, the Park government met with poor popular support due to its harsh repression of labor union activities and the restriction on the opposition political parties. As a consequence, the authoritarian government barely managed to secure a majority of votes in the presidential elections. The wish to elevate its political legitimacy and popularity appeared clearly in the 1963 New Year message, in which Park declared, “We must realize the establishment of a welfare state with the strong power of execution... We are going to introduce Medical Insurance and Industrial Accident Compensation Insurance” (Shin 2003, 63). The fact that this message was spoken just before the 1963 presidential election demonstrates that the Park regime began to seek to gain political support from the mass public through what it considered would be popular measures and ultimately help win elections.

Although the initial intension of social insurance programs that Park initiated in the 1970s was to protect civil servants, military personnel, and skilled workers of large firms as part of industrialization strategies, it is apparent that electoral competition and political pressures served as another catalyst for the gradual expansion of those programs in Korea (Ramesh 2004, 12). For example, when Kim Dae-Jung, a leading opposition leader, nearly defeated Park in 1971, Park Chung-Hee hurried to introduce NHI as a winning strategy to marginalize the political opponents of the regime (Figure 18). At the same time, the government proposed an

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<sup>75</sup> Despite some electoral competition, however, Korea was still under a tight political control with pervasive abuses of executive power. Even after Park was assassinated in 1979, Korea experienced another period of authoritarian rule under Chun Doo-Hwan (1981-1987).

ambitious national pension scheme in 1972 to secure popular support for its rule on the one hand and mobilize savings for its heavy industry drive on the other hand (Haggard and Kaufman 2008, 136-137).<sup>76</sup> As seen in the figure below, electoral competition has been intensifying over time since the 1963 presidential election. Due to this, the next presidents had to pay as much attention to social security as their predecessors, and which contributed significantly to the expansion of social welfare (although all of them never abandoned the principle of productivist welfarism).



**Figure 18.** Candidate Competition in Presidential Elections in Korea

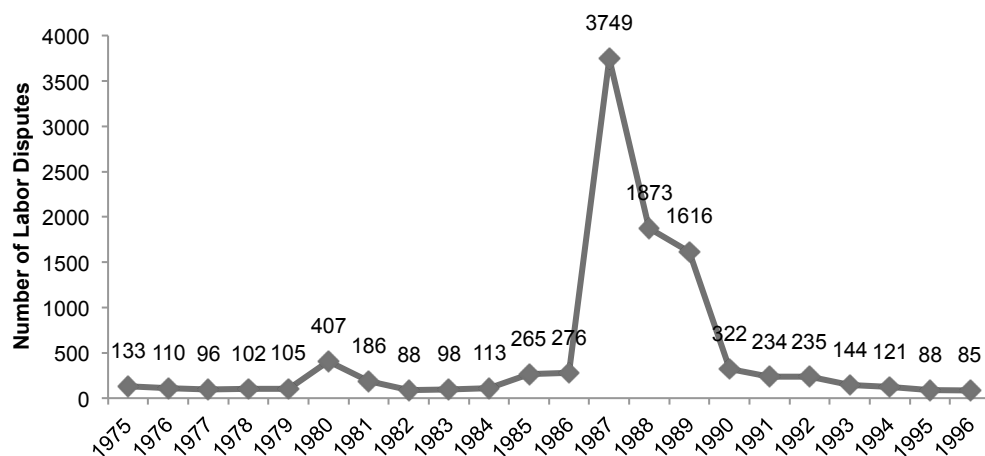
*Source:* National Election Commission of Korea (<http://www.nec.go.kr>)

General Chun Doo-Hwan, who seized political power after Park was assassinated in 1979, did little to change the authoritarian rule of the Park regime during his presidency (1980-1987). Although his authoritarian ruling party won all presidential and general elections during the 1980s, Chun and his party received less than 40 percent of the votes. The Chun regime could win elections continuously only because of a repetitive split in votes among the opposition parties

<sup>76</sup> As I explained in the previous section, the implementation of the national pension scheme was postponed with the first oil shock and not revived until the late 1980s when Korea became democratized.

(Lee 1997, 6-7). The small margin of victory in the elections was a wakeup call for the ruling party, making them more seriously consider social security programs to buy political support, just as Park had attempted. However, as corruption surrounding President Chun became intolerable for the people, millions of Koreans participated in nationwide protests against the dictatorship of Chun calling for democracy. Particularly, the year of 1987 witnessed a big explosion of the largest and most extensive protests in Korea (Kim 2003). Chun's response to the movements, however, was harsh and ruthless, bringing about the deaths of several college students and workers.

In addition to the wave of democratic movement that heightened political competition, political challenge against the authoritarian government came from the rise of massive labor disputes in the late 1980s (Mo 1996). Particularly, labor unrest and industrial action skyrocketed in 1987. While the average number of labor disputes was only 165 during 1975-1986, the number dramatically increased to 3,749 in 1987 (Figure 19).



**Figure 19.** Labor Disputes in Korea

*Source:* Korea Statistical Information Service (<http://kosis.kr>); Woo (2004, 76).

Because organized labor in Korea had remained repressed for a long time, the Chun government used to ignore calls for basic labor rights and working conditions. Facing the unprecedented rise of protests and labor strikes, however, the Chun regime could not continue to simply repress citizens and workers. To deal with the political resistance to his rule, Chun publicly promised a series of sociopolitical reform, including the expansion of social welfare programs, as a winning strategy. He announced in 1986 that he would extend medical coverage to rural residents and the urban self-employed. The Chun government also announced its intention to launch a national pension scheme and introduce a minimum wage. When the protest of 1987 forced the adoption of a direct presidential election system, Roh Tae-Woo—the chairman of the ruling party—integrated these social policy initiatives into his presidential election pledges.

Without doubt, the 1987 presidential election and the 1988 general election served as a significant watershed in the history of Korea's social policy. Even though Roh Tae-Woo won the 1987 presidential election due to the opposition parties' failure to establish a united front, the opposition parties took over the majority in the National Assembly in the following 1988 general election and played a key part in criticizing the Roh government and its connection to the authoritarian rule of the past Chun government. As one of the methods to cope with political challenges in the midst of democratic transition, the Roh government implemented the National Pension Act in 1988. For the government, the implementation and expansion of NPS to cover a wider population within the productivist welfare system were highly attractive as a key to the questions of political legitimacy and capital accumulation (Hwang 2007, 140). These political and economic benefits led the Roh government to create a “low-contribution and high-benefit” structure of national pension, downplaying the long-term financial sustainability of the NPS. Thus, prior to the 1997 financial crisis, the Korean productivist welfare state continued to expand



its inclusive programs (1) with the consideration of economic effects of social insurance and (2) as a response to electoral competition and political challenges. Nonetheless, the overall scope and comprehensiveness of social insurance programs were still limited.

However, the presidential election that brought Kim Dae-Jung to office in the midst of the 1997 financial crisis became a landmark event that ushered in a new era of social policy. Kim's victory was indeed more than a mere case of a power shift. It was a signal of Korea's transition from a long-lasting authoritarian/conservative one-party rule to a new form of pluralist democracy. Literally, the financial crisis of 1997 and Kim's presidential election swiftly turned Korea toward a full-scale reform in almost all areas.

When a sudden disruption of the economy revealed Korea's inadequate level of social protection under the existing productivist welfare system, one might expect that the Kim government would adopt a more protective—if not the European style of social democratic—welfare policies. However, strong pressure from the IMF (and the U.S.) for further market opening and structural adjustment policies coupled with market-oriented social security put the Kim government into a dilemma, especially because of Kim's close relations with labor (Haggard and Kaufman 2008, 249). While the IMF pressed Korea to facilitate corporate restructuring through the increase of labor-markets flexibility, Kim Dae-Jung had proactively embraced civic movement groups and labor unions unlike the former governments that had relied on developmental coalition and economic bureaucrats for the regime's political fortune. Obviously, it was a very tough task for the center-left Kim government to carry out greater labor-market flexibility.

To ensure both a smooth implementation of labor-market reform and the protection of workers who were adversely affected by the financial crisis, the Kim government formed the

Tripartite Commission comprising representatives of the government, business, and labor. Recognizing the new role and influence of the general public in the era of democratic transition, the Kim government used the political inclusion of labor and civil society as a buffer to pave the way for neoliberal adjustment policies (Yang 2004, 199). Civic organizations and labor unions also began to participate in social policy making through the Tripartite Commission.<sup>77</sup> Thus, the expansion of social protection programs (such as the NPS, the NHI, the Minimum Living Standard Guarantee, and so on) was a strategic compromise among several actors to compensate for neoliberal structural adjustment. In this sense, the underlying social policy drive of the new democratic regime was a signal of the shift from limited IPW to comprehensive IPW in a globalized Korea. The shift was of course made with a continuity of the essential nature of productivist welfarism (Moon and Yang 2002).

As explained above, democratic transition coupled with the intensive electoral competition played a critical role in the expansion of social security programs in Korea. Also, the participation of civic organizations and labor unions in decision-making processes even pressed the Kim Dae-Jung government to reject any market-oriented reform of social insurance programs. For example, the World Bank had recommended to (i) split the current national pension system into a basic and earning-related component, (ii) integrate the retirement allowance in a funded and privately managed defined-contribution (DC) plan, and (iii) integrate the national pension system with the other three occupational pension schemes (Yang 2004, 201). However, civic organizations exercised strong influence on the government to maintain the existing defined-benefit (DB) structure of the NPS. Although the Kim administration actively adopted a series of neoliberal economic policies proposed by the IMF, the influence of

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<sup>77</sup> The number of civic organizations in 1998 was about 12,000, which was a result of a 12 percent increase in two years (Shin 2003).

international financial institutions was not automatically transmitted into the social policy-making process.

Another factor that calls for attention is the fact that public attitudes toward social policy have been changed significantly as democratic politics come to be practiced widely in Korea. According to surveys conducted by Shin and Rose in 1997 and 1998, there was a huge change in value orientation of Korean people with respect to the provision of social protection, which in turn acted as constraints on the social policy formation. Before the financial crisis, 51 percent of the respondents thought that individuals should be responsible for their own welfare (Table 18). Because the social security system was fully funded by employers and employees with little financial commitment of the government, the mass public believed that social protection should be individuals' responsibilities (Shin 2003, 191). However, this attitude changed greatly when a substantial portion of the population lost jobs and went bankrupt during the economic crisis. In 1998, only 17 percent of the respondents supported the same notion whereas 83 percent answered that the government should bear the responsibility. This survey is one of the examples suggesting that the financial crisis and the following increase of labor-market flexibility brought about a significant change in people's attitudes toward social protection, producing more "critical citizens" and "dissatisfied democrats" in Korea (Shin and Rose 1998; Norris 1999).<sup>78</sup>

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<sup>78</sup> Similar survey results are presented in the following section in which I contrast Korea with Singapore to show how different public attitudes Korean citizens (with IPW) and Singapore citizens (with MPW) reveal regarding their approaches to social welfare.

**Table 18.** Attitudes to the Government's Responsibility for Individual Welfare

	May 1997	October 1998
Individual Responsibility	51 %	17 %
Government Responsibility	49 %	83 %

*Source:* Shin (2003, 192).

As examined so far, the development of Korea's IPW was an outcome of economic strategies and political circumstances. For its market-distorting strategy of economic development, the Park Chung-Hee regime adopted a series of limited IPW measures, maintaining a state-dominated alliance with business while repressing labor. The institutional backbone of social protection was social insurance that aimed to protect government employees, military personnel, and large-firm workers. However, electoral competition and the subsequent arrival of democratic rule drove the political leadership to pay more attention to the importance of social insurance programs as a political tool. More importantly, the 1997 economic crisis accelerated the development of IPW, generating immense political pressure among "critical citizens" for a more comprehensive social security system and insurance benefits.

All these experiences of Korea are quite different from those of other MPW states—especially Singapore. Unlike the case of Korea, Singapore has been greatly influenced by foreign capital, and its politics also enhances the market-oriented political attitudes of the people. The next section highlights the evolution of Singapore's MPW, showing how the economic structure and political conditions have strengthened the hegemony of the ruling party and its market-oriented productivist welfare in Singapore.

### 4.3 SINGAPORE

Productivist welfarism in Singapore is austere and market-oriented more than any other East Asian states. Singapore's social protection system provides neither a meaningful redistributive mechanism nor adequate benefits to offset social risks. It is because the free-market doctrine that has been deeply entrenched in the society dominates the social policy area. A UN report describes the nature of Singapore's market productivist welfare (MPW) succinctly: "Every Singaporean is imbued with the sense that rewards can only be brought about through hard work, based on the principles of meritocracy and self-reliance. We do not believe in social handouts" (Wijeysingha 2005, 197). This principle is *the* norm of almost all the social policies in Singapore.

Old-age pension is compulsorily funded by private contributions. Healthcare is publicly provided, but citizens are responsible for a significant portion of the costs. About 90 percent of the citizens live in housing administered by the public sector, but this high rate does not involve any substantial government expenditure. The Singapore government provides stringently means-tested income supports and other welfare services with extremely low benefits (Ramesh 2004, 10-11). Primary and secondary education that is believed to be a necessary condition for economic growth is the only program almost entirely provided and funded by the government. As such, Singapore's productivist welfarism is characterized with a virtual absence of tax-financed social welfare and, unlike Korea's IPW, there is no redistributive risk-pooling even among industrial workers who are considered strategically important for economic growth.<sup>79</sup>

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<sup>79</sup> The Medifund Scheme, a healthcare program, started in 1993 targeting at the poor and indigent residents. Yet the benefits are only for those who pass extremely stringent means tests.

At the apex of this Singapore's MPW lies the Central Provident Fund (CPF), a compulsory individual savings scheme which is based on a nearly pure defined-contribution (DC) principle. The People's Action Party (PAP) that has governed Singapore over the past 50 years developed the productivist ideology, coupled with the authoritarian rule and free market doctrine. Reflecting the productivist thrust, the PAP designed the CPF as a government-managed savings scheme to deal with social risks. The scheme was believed to encourage self-reliance by leading people to rely on their own resources to meet their retirement and other social protection needs. The CPF is comprised of contributions from employers and employees to serve a variety of objectives in old-age pension, health, housing, and overall economic management (Low and Aw 2004). What makes Singapore distinctive from other types of PWC in East Asia is its heavy reliance on the market-oriented CPF system that involves few risk-pooling and redistributive elements.

This section discusses the development of Singapore's MPW. The first half seeks to trace the features and problems of the CPF, focusing on how the CPF operates as the institutional centerpiece of Singapore's social security system. The second half examines economic and political conditions under which the PAP has constructed the CPF system combining a developmental ideology with the pursuit of free-market and authoritarian rule. As discussed below, the distinctiveness of Singapore's MPW is largely derived from its high reliance on foreign investment and the high level of policy autonomy.

### **4.3.1 Development of the Market Productivist Welfare Capitalism**

#### **4.3.1.1 Institutional Framework of the CPF**

The most striking feature of Singapore's MPW is its nearly exclusive reliance on the CPF that is a mandatory and publicly managed defined contribution (DC) system (CPF Board 2005).<sup>80</sup> The CPF is a compulsory savings arrangement that employers and employees contribute a portion of the wages to the employees' individual account. When the CPF was established in 1953 and came into effect in 1955, it was initially intended to accumulate funds for retirement purposes, but since the 1960s, the Singapore government has vastly expanded the scope of the CPF not only to cover old-age pension but also to meet other social security needs and economic objectives. Currently, the CPF deals with old-age pension, housing, healthcare, investment, and loans for financing tertiary education.<sup>81</sup>

Under the CPF system, employees receive what they saved during their working life. Therefore the CPF does not cause any financial deficits for which the government is responsible.<sup>82</sup> Because self-reliance is its central principle, the CPF does not provide any programs such as public assistance for the poor and the unemployed, and consequently the general public cannot get help from the CPF if they lose their jobs. Of course, the government has social protection programs such as Interim Financial Assistance and the Rent & Utilities Assistance Scheme for those who are in financial hardships. But those basic benefits are provided on a very stringent means-tested basis (Ku 2003, 137). The number of people who

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<sup>80</sup> General information about the CPF scheme is available online at <http://www.cpf.gov.sg>.

<sup>81</sup> The house-purchase goal is a unique feature of the CPF. In Singapore, the CPF substitutes for the absence of a housing mortgage market. CPF Members are permitted to use their account balances to make a down payment on public housing constructed by the government's Housing and Development Board (HDB). <http://www.hdb.gov.sg>.

<sup>82</sup> In Singapore and Malaysia, the government directly administers provident fund arrangements, whereas it is done by private firms in Chile and Australia.

received these kinds of public assistance was 2,867 in 1988, 2,070 in 1998, and 2,772 in 2007, forming less than 0.1 percent of the total population (MCYS 2007). These statistics indicate that Singapore's social security and welfare is highly dependent on employment and the market, and the CPF is institutional bedrock of "commoditized" social policy.

Participation in the CPF is compulsory for the employed, except for foreign workers and part-time workers. The self-employed are required to participate in the medical component of the scheme and may participate in the overall scheme on a voluntary basis, though only a small percent have chosen to do so.<sup>83</sup> The CPF Board fixes the CPF contribution rates. The rates of both employees and employers have varied over time for various age groups depending on economic circumstances. The account holders can withdraw their accumulated savings when they become 55 years old. After withdrawal at 55 years, the members can spend or invest their CPF funds as they wish or continue to contribute to their accounts if they remain employed. Yet their contribution rates become much lower than that of younger generations. As of 2007, the CPF has a membership of 3.16 million, forming about 85.9 percent of the labor force (CPF 2007).

To reflect the multi-purpose function, members' CPF accounts are divided into three sub-categories: Ordinary, Special, and Medisave (Jones 2005). First, the Ordinary account is the main component of the CPF. For those below the age of 55, about 60-75 percent (depending on age) of the total savings go into the Ordinary account. The Special account holds 10-20 percent, and the rest 15-20 percent goes to the Medisave account (Table 19). The Ordinary account savings earn interests at a rate offered by local commercial banks for a one-year fixed deposit, subject to the minimum rate of 2.5 percent per year. Funds in the other two accounts receive an

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<sup>83</sup> The size of the self-employed is relatively small. Compared to the total workforce in Singapore, they account for approximately 15 percent of the population (Asher and Rajan 2002, 238).



additional 1.5 percent of interest more than the Ordinary account. The Special and Medisave accounts were designed to have a higher interest rate to ensure sufficient savings for retirement and medical services (Ramesh 2004, 52).

**Table 19.** CPF Contribution Rates

Employee age	Contribution Rate (% of wage)			Account (% of wage)		
	Employer	Employee	Total	Ordinary	Special	Medisave
35 & below	16	20	36	23	6	7
35-45	16	20	36	21	7	8
45-50	16	20	36	19	8	9
50-55	14	18.5	32.5	13.5	9.5	9.5
55-60	10.5	13	23.5	12	2	9.5
60-65	7	7.5	14.5	3.5	1.5	9.5
65 & above	6.5	5	11.5	1	1	9.5

Source: CPF (<http://mycpf.cpf.gov.sg>).

Note: For private sector employees with monthly wages above S\$1,500.

Funds in the Ordinary account are basically used for housing, tertiary education, and mortgage insurance. Regarding the housing issue, the government allowed in 1968 CPF members to use their funds for the purchase of a HDB (Housing and Development Board) apartment. In 1981, the scheme was extended to the purchase of private residential units.<sup>84</sup> The Ordinary fund is also used for tertiary education. In Singapore, the government subsidizes tertiary education, yet students are still required to pay a considerable portion of tuition and fees. To finance their education, students can draw upon the savings of their parents. The CPF members can also withdraw a portion of their Ordinary funds for the investment in approved stocks and commodities (Jones 2005, 76-84).

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<sup>84</sup> As the CPF contribution rates decreased in the late 1980s, house buyers were permitted in 1991 to use their special account savings to purchase residential property (Low and Aw 2004).

The second account—the Special account—was set up in 1977 to supplement the Ordinary account and currently holds 10 to 20 percent of the savings. It is intended to provide for retirement exclusively. The members can withdraw their funds at the age of 55, except a minimum sum that should be left in the account to prevent the members from wasting away their money in the early years of retirement. The savings are released in installments from the age of 62 onwards until it is exhausted.

Lastly, the Medisave account, which was created in 1984, consists of the rest 15 to 20 percent of the savings, reserved for the cost of health care of CPF members and their immediate family. Since 1992, the contribution rate has been determined by the age of the CPF member. The contributions continue until a ceiling is reached, which is currently S\$43,500.<sup>85</sup> Once this is reached, contributions are no longer necessary unless the Medisave account is drawn upon for medical treatment and so falls below the ceiling. Any excessive contribution is transferred to the Special account if the member is below 55 years old. While the self-employed may enroll the above two accounts on a voluntary basis, the Medisave program is mandatory for both salaried employees and the self-employed.

The rate of contribution to the CPF has varied widely over the years. At the time of its introduction in 1955, the rate was 5 percent each for employers and employees, forming a total of 10 percent of the wages. Later, the CPF contribution rate increased up to 25 percent each for both. After a series of ups and downs, the rate was set at 20 percent for employees in 1994, while the rate for employers has been between 10 to 20 percent (Table 19).

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<sup>85</sup> “CPF Minimum Sum To Be Raised to \$139,000.” *Asiaone Business*, May 30, 2012 (<http://www.asiaone.com/Business/News/My%2BMoney/Story/A1Story20120530-349337.html>)

#### **4.3.1.2 Assessment of the CPF**

Despite its near-universal coverage and high contribution rates, it is questionable whether the CPF can provide an adequate protection against social contingencies (Ramesh 2004, 74). First, the low level of interest returns that CPF account holders earn on their funds is one of the major concerns. The withdrawal of the accumulated savings of the CPF is available only upon reaching the legal retirement age or meeting some conditions. In particular, the funds in one's Special account are not normally available for withdrawal for decades, so they are largely vulnerable to inflation, which means that inflation can eat away the value of the accumulated savings. This is why, for effective social protection, investment returns of the funds should be higher than inflation rates.

However, in order to achieve the goal of high return rates, the CPF funds should be invested in risky financial products, which in turn require a prudential regulatory system and highly efficient capital market. Without meeting such conditions, the CPF cannot be a major social security institution. In reality, however, the CPF Board has invested the accumulated funds in relatively "safe" products like government bonds over the decades. As a consequence, the CPF often produces returns that sizably lag trends in real wages (Williamson et al. 2012, 85). For example, during the period of 1983-2000, the CPF provided average annual returns of merely 1.8 percent, which was much lower than the inflation rate. In 2008, the return rate was about 2.5 to 4 percent while the inflation rate was 6.5 percent (CPF Board 2010). This is why the CPF is criticized for its inadequacy as a basic social security institution for retirement and other social security services. To make up the relatively low return rates, the Singapore government has gradually liberalized the CPF, allowing account holders to determine at their discretion how to invest their savings (though there are still limitations to the available options). And this

liberalization of the CPF has increased the overall level of “commodification” of social welfare, thus transferring the responsibility for the fund management to individuals (Asher 2004).

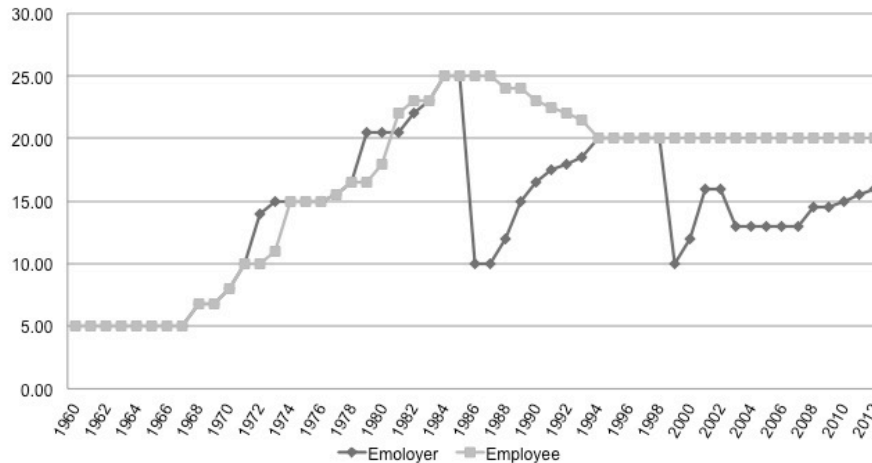
The second problem is that, despite the high contribution rates (up to 40 percent by employers and employees), replacement rates are relatively low not only because of modest return rates but also due to a high rate of pre-retirement withdrawal (for housing, health, education, etc.). Without doubt, the early withdrawal of the fund for retirement results in a considerable decrease in the replacement rate. Several studies report that estimated replacement rates of the CPF for retirement range from 25 to 35 percent of the last-paid salary (Asher 2004, 23; McCarthy et al. 2001, 38; Ramesh 2004, 73). These rates do not meet the minimum for maintaining one’s standard of living. It is projected that about 60-70 percent of the workers in the 50- to 55-year-old age group have no sufficient resources in their CPF account (Lim 2001, 374). This fundamental problem of low replacement rates is also associated with the absence of redistributive risk-pooling mechanism that is a problem inherent to any individual savings schemes like the CPF. While the basic structure of savings schemes can enable the government to avoid financial responsibilities for the maintenance of social security system, those without sufficient wages have little in their CPF account to use for their retirement or some other social security services.

The third problem is the fluctuation of contribution rates. As seen in Figure 20, the Singapore government has adjusted the contribution rates frequently since the late 1960s, mainly in a way to reduce the costs of the business sector by lowering employers’ contribution rates. The frequent adjustment of the contribution rates was mostly due to regional and global competition with countries like Malaysia, Thailand, and China where land and labor are much cheaper (Jones 2005, 94). The concern about cost competitiveness prompted Singapore not only

to develop comparative advantages in knowledge, expertise, and infrastructure but also to keep business operating costs as low as possible. Because one of the determinants of the higher business costs in Singapore is the higher level of wages, the Singapore government has often attempted to moderate wage costs of business by reducing the CPF contribution of employers. For example, during the recession of 1985, the employers' rate decreased from 25 percent to 10 percent, and after the 1997 Asian financial crisis, the rate was cut from 20 percent to 10 percent. Since 2003, the employers' contribution rate has been determined at 13 to 16 percent while employees' rate remained at 20 percent. Regarding this issue, former Prime Minister Goh Chok Tong said, "we will not have any formula to decide what the actual CPF rate should be at any point in time... We will look at the prevailing economic conditions, and assess accordingly... We will only adjust it from time to time when conditions have changed significantly" (Jones 2005, 95). As such, the adjustment is often recognized as a means to keep Singapore competitive in the global market. However it also undermines the financial stability of the CPF.<sup>86</sup>

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<sup>86</sup> In Korea, the contribution rates by employers and employees have remained mostly same for the last two decades. The rates of NPS contribution were 2 percent during 1988-1994 and have been 4.5 percent since 1999. During the period of 1995-1998, employers' rate was rather higher (4 percent) than that of employees (2 percent). In the case of NHI, the contribution rates have been adjusted from 1 to 2.54 percent, yet the same rates have been applied to both employers and employees from the very beginning of the program.



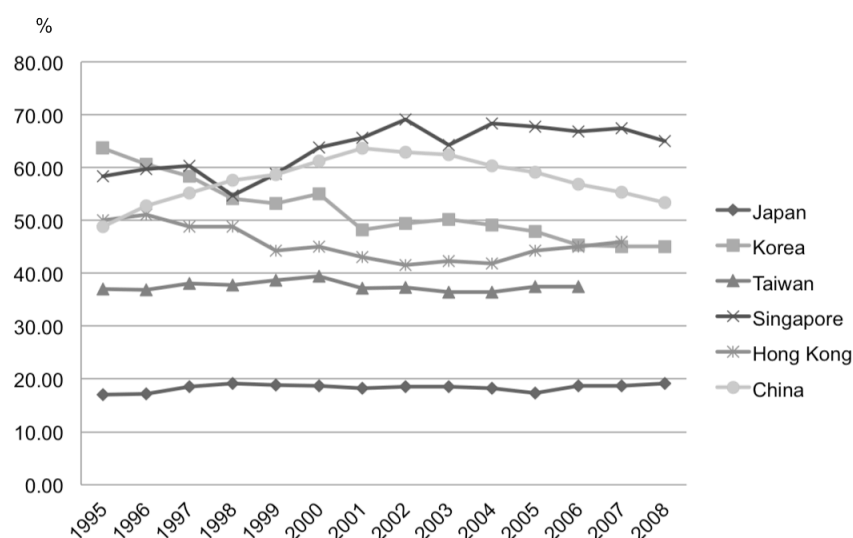
**Figure 20.** Contribution Rates of the CPF (%)

*Source:* CPF Annual Reports, various years.

The last but not least problems is the relatively high rate of private health expenditure. In Singapore, health expenditure is mainly channeled through one's Medisave or out of pocket. The Medisave—a compulsory saving account that was established within the CPF in 1984 to reduce the government's involvement in the financing—is an official health care institution managed by the government. However, it does not take a significant portion of the total national health spending. By the early 2000s, it accounted for only 10 percent of total health spending (Haggard and Kaufman 2008, 244; Ramesh 2004, 101).<sup>87</sup> Since the Medisave was originally designed to accumulate funds to cover expensive inpatient care, the funds in the Medisave cannot be used for outpatient care, just except for some special cases. Also, there are limits on the amount that can be withdrawn. As a result, people should spend a substantial amount of out-of-pocket money for outpatient care although funds in their Medisave account are their own savings.

<sup>87</sup> In 1990, the Singapore government established a publicly managed health insurance scheme called Medishield in order to help CPF account holders to cover expenses of surgery and out-patient treatment. But the Medishield is a voluntary insurance program.

As seen in Figure 21, the private financial burden of Singaporean households has increased continuously over the years. Private health expenditure measured as percent of total health expenditure is considerably higher in the region, ranging from 58 percent to 69 percent during 1995 to 2008. While households take a considerable share of total health spending, the Singapore government spends only on subsidy to public hospitals and outpatient clinics, capital expenditures of the Ministry of Health, and the cost of providing medical care to state employees. In addition, the role of the government is focused on the regulation of public hospital charges for treatments (Holliday 2003, 90).



**Figure 21.** Private Health Expenditure in East Asia (% of total health expenditure)

Source: WHOSIS (WHO); 2008 Statistics of General Health (Department of Health, ROC)

Note: Private health expenditure is the sum of outlays for health by private entities, such as commercial or mutual health insurance providers and direct household out-of-pocket payments.

### **4.3.2 Political Economy of Singapore's MPW**

The social policy framework in Singapore was the result of its colonial history and the geographical settlement that produced a unique set of socioeconomic conditions for the state-building process during the postwar period. As a tiny and resource-poor nation, Singapore was placed in a global context that called for keen political and economic competitions for survival. In such a condition, a statist approach might be the most appropriate and feasible strategy, and indeed the Singapore government set out a series of economic policies in accordance with its imperatives for survival.

Under domestic and global pressures for rapid industrialization, social policy was also understood on the basis of its relationship to the primary goal of economic growth. The Singapore government established a social policy model—as an instrument to assist economic development—involving the production of skilled labor and capital accumulation. More specifically, the goal of social policy was the cutting of the severe unemployment, the expansion of primary health facilities and schools, and urban regeneration and slum clearance (Wijeysingha 2005, 197). For this purpose, the PAP established the CPF in 1955—a compulsory savings scheme that calls for individuals' responsibility for social protection.

The Singapore government had firm belief in the CPF for some important features of the scheme (Jones 2005, 78-79). First, since the funds are accumulated out of the savings of the CPF members, the government does not need to appropriate tax revenue. This self-reliance structure is expected to prevent an unnecessary drain on the government budget, allowing a significant portion of government expenditure to be channeled into economic and infrastructure projects. It also enables taxation to remain at a lower level, which is a great incentive to foreign investors. Second, the CPF encourages the self-help orientation of the people. The CPF provides incentives



to better off others through education, skill acquisition, hard work and career development. In Singapore, it is widely believed to be “fairer and sounder to have each generation pay for itself and each person save for his/her own pension fund” (Lee 2000, 105).

As such, the need of rapid economic growth via “market-conforming” economic policies—especially trade and capital markets—provided a backdrop for the development of the CPF, forming the crux of MPW in Singapore. At the same time, Singapore’s long-lasting authoritarian political system has facilitated the expansion of the CPF. The policy trajectory of self-reliance would have not been possible unless there was relatively high level of support among the mass public for the paternalistic regime and its role of trustee in policy areas.

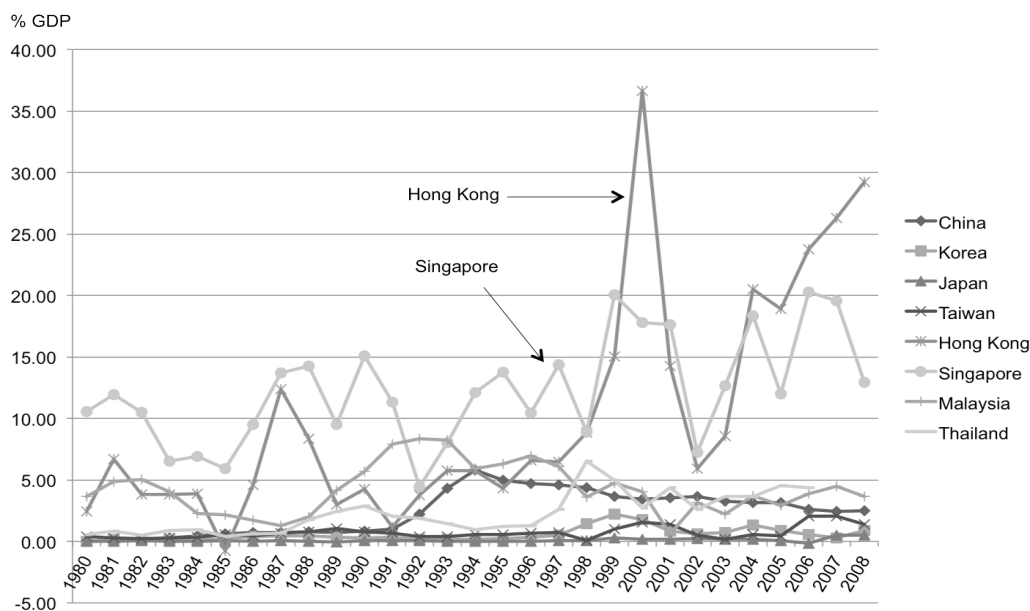
#### **4.3.2.1 Economic Contexts**

Singapore became a trading post of the English East India Company in 1819 and later a British colony. Under the British colonial rule, Singapore had thrived as a major entrepot port in Southeast Asia. The driving force behind the building of Singapore was commerce from the very beginning. However, when Singapore became independent of Britain in 1959 and then of Malaysia in 1965, its future became uncertain. Also, political struggle between the PAP leadership and the left-wing faction drove Singapore into instability. Moreover, when the British planned to close its military base in Singapore in 1968, confidence in national economy was shaken considerably because the British military base accounted for about 20 percent of Singapore’s GDP and employment. Indeed, for years after independence, social infrastructure and housing conditions were deteriorated, and the nation was plagued with widespread unemployment and industrial unrest (Tang 2000, 39-40).

To deal with the political and economic challenges, the PAP embarked on the import-substitution industrialization (ISI) and then the export-oriented industrialization strategy from

1965 onwards, with attempts to attract foreign investments by providing tax incentives and developing infrastructure. For a resource-poor state like Singapore, there were few options other than being actively integrated into the world economy by internationalizing its economic structure. As a new independent state with few comparative advantages, the Singapore government was desperate for foreign capital and firms (Kwong 2001, 5).

The initiation of economic openness and foreign exposures was coined with the “developmental state” that highlights the strong political and economic leadership and a tight control over labor. Unlike Korea where a local capitalist class (i.e., *chaebol*) emerged with real economic and political power to protect its interests, the PAP in Singapore disregarded the demands of the local capitalist class, let alone the working class (Tremewan 1994, 34). The PAP’s control over workers and its offer of tax incentives to foreign investors were very successful in attracting foreign investment. To be sure, the salient feature of the development strategy in Singapore was the role played by foreign capital and firms, particularly in the manufacturing and financial services sectors. Singapore’s political stability, generous tax concessions, good infrastructure, and educated and docile labor made Singapore a favored site for foreign investment, and as a result, the scale of foreign investment into Singapore became tremendously larger. Over the last decades, the ratio of FDI to GDP has been up to 20 percent, much larger than that of any other East Asian economies, except for Hong Kong (Figure 22).



**Figure 22.** FDI Inflow in East Asia

*Source: UNCTAD, World Investment Directory 2009.*

Singapore's capital stock has also increased 33 fold since 1960, doubling on average once every six years. This rapid increase of capital accumulation resulted in a 10-fold growth in the capital-labor ratio during 1960-1992. Although many observers thought that, due to the heavy hand of state-centered developmentalism, East Asian finance was largely weak and needed reforms as seen in the 1997 financial crisis, Singapore was an exception. Singapore has been successful in creating a strong financial sector since the early 1960s. Between 1980 and 1991, foreign investment represented 25 percent of fixed capital formation and over 60 percent of investment in manufacturing (van Elkan 1995, 5). Based on stable politics, highly favorable regulatory environment, low taxes, skilled labor force, and no barriers to the entry and repatriation of capital, Singapore became a highly efficient financial center of the region. Singapore is now the fourth largest foreign exchange trade center in the world, following only London, New York, and

Tokyo (Wan 2008, 287).

Another notable fact is that the state-led developmental strategy and the free-market principle led Singapore to have a high exposure to international trade. Singapore's trade as shares of GDP increased sharply to 300-400 percent since the 1960s (Table 20). This growth is really remarkable, compared to other IPW states in the region. Although the IPW states (Korea and Taiwan for example) are also major trading nations that export and import more than OECD states, their international trade is relatively less significant than Singapore. Particularly, foreign firms played a significant role in the trade area in Singapore. Foreign firms produced over 70 percent of manufacturing output as early as the 1970s, and they accounted for 58 percent of employment and 92 percent of exports in 1978 and 59.5 percent of employment and 86 percent of exports in 1988 (Ramesh 1995, 235).<sup>88</sup>

**Table 20.** Trade in East Asia

	% of GDP					
	1960	1970	1980	1990	2000	2010
Japan	21.0	20.0	27.8	19.7	20.3	29.2
Korea	15.8	37.4	72.0	57.0	74.3	102.0
Taiwan	30.2	59.9	104.1	86.5	105.3	118.4*
Hong Kong	175.7	178.7	178.3	252.6	282.1	440.3
Singapore	.	271.2	412.2	344.8	371.8	385.9
China	.	5.3	21.7	29.2	44.2	55.2
High Income OECD	22.5	25.7	36.7	35.1	44.8	50.1
Middle Income	.	20.0	32.7	38.2	52.7	56.6

*Source:* Word Bank, *World Development Indicator*; *Penn World Table 7.0*.

*Note:* Data of 2009.

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<sup>88</sup> In Korea's manufacturing sector, foreign firms accounted for only 10 percent of employment and 27 percent of exports in 1978 and, in 1986, 9.5 percent of employment and 29 percent of exports (Ramesh 1995, 235).

The extremely high degree of dependence on foreign capital and trade restricted government capacity to spend on non-economic and non-productive areas, which is of great relevance to the development of Singapore's social policy. That is, a market-based meritocracy consolidated a materialist value system, which in turn reinforced market-oriented productivist welfarism emphasizing self-reliance (Wijeysingha 2005, 199). In Singapore, the role of the government mainly focused on the conditions for capital accumulation, the reproduction of labor, and the promotion of trade. Public expenditure on social policy was considered only when there would be a positive impact on human capital development (such as education and primary healthcare).

In this regard, a compulsory savings scheme was exactly what the PAP was looking for in its quest for productivist welfare. First, the function of the CPF was mainly to ensure that workers do not need to rely on future expenditure either by the state or the corporations for their retirement, housing, and medical care. Parallel to the value of self-reliance, the PAP could implement social and economic policies based on a marked anti-welfare principle, without concern about funding sources for the national social security system. The emphasis on self-reliance was an imperative component to make sure the foreign capital would stay in Singapore.

Second, the CPF has been used to consolidate the local capital accumulation process. Under the forced savings scheme, all employees should contribute about 20 percent of their salary to their CPF account. Because the money in the account cannot be withdrawn prior to retirement without government-approved reasons, the CPF has led to a high national savings rate. In 1970, there were 0.6 million contributors who saved more than \$0.8 billion. By 1980, 1.5 million workers had total savings of \$9.6 billion and, by 1990, \$40.6 billion was made by 2.2 million workers. As of 2000, 2.9 million workers saved \$90.3 billion (Kwong et al. 2001, 36-38). Workers' long-term savings in the CPF accounts have provided a huge amount of cheap capital,

and the government borrowed the savings in the form of internal debt to finance infrastructural development. Because the account holders did not have a choice over how their savings are to be invested, the government could use them as it intended for economic development. In a nutshell, the CPF has been used as an effective instrument for domestic capital accumulation.

Third, the CPF contributions by the employers are a kind of hidden wage for the employees. A series of revisions of employers' contribution rates, therefore, could greatly affect not only the amount of savings in the account but also the overall level of labor costs. This implies that the government could wield its influence on the economy by adjusting the employer's contribution rate if necessary economically (Tang 2000, 46). Indeed, the PAP did not hesitate to use the contribution rate as a method to reduce the labor costs during the 1985 economic recession and the 1997 Asian financial crisis. A decrease in the rate of employers' CPF contribution helped lower business costs to keep Singapore competitive in the global market. Recognizing this mechanism, the Confederation of Industries used to ask the government to cut the rates further, for example, from 20 percent to 5 percent in 1998 (*Asiaweek*, November 13<sup>th</sup>, 1998). Obviously, this system is vulnerable to social risks but is favorable for the productivist use of social policy.

As such, Singapore's "market-conforming" system and economic openness have greatly influenced the formation of MPW, developing the CPF in accordance with the self-reliance principle in both economic and social areas. Yet, it is also necessary to look at political conditions under which the government could foster the expansion of the CPF. The next section deals with this issue.

#### **4.3.2.2 Political Contexts**

After the end of World War II, Singapore experienced periods of competitive politics striving for full self-governance. While the Communists and left-wing forces had developed a strong tie with the labor unions and the young intellectual Chinese Singaporeans, the liberal-nationalist PAP did not have such bases at the grass root level (Quah et al. 1985). To cope with political challenges from the strong unions and left-wing parties, Lee Kuan-Yew—the leader of the PAP—initially adopted a redistributive social policy. However, when the PAP swept into power by earning a sizable electoral majority (47 percent of the vote and three quarters of all seats) in the 1959 parliamentary election, it began to reverse its initial policy, repressing labor union activities and combining one-party authoritarian rule with a single-minded pursuit of “developmental liberalism” (Haggard and Cheng 1987, 102). As the political influence of the PAP became greater, the labor-centered redistributive initiative was abolished, and the policy focus shifted to a new course of growth strategies—i.e., the attraction of foreign capital, the increased role of the government in industrial finance, and the control on the labor unions. Particularly, its tight control over labor shaped the political landscape that fostered market-oriented productivist welfarism in Singapore.

The PAP consolidated its one-party dominance and introduced repressive labor laws to extend incentives to foreign capital. It also attempted to eliminate the labor movement by forming its own unions in 1961. Furthermore, the 1968 Employment Act and Industrial Relations Act eliminated many labor rights and protections, giving employers significant discretionary power over most aspects of labor relations. All these policies aimed to secure its policy autonomy and to suppress labor resistance to the low-wage policy. The PAP firmly believed that its control on labor would be a great inducement to foreign investors (Tremewan 1994, 33).

Thus, the PAP has maintained the hegemony in the political terrain over the last five decades since the seizure of political power in 1959. During this period, the government placed strong limits on and tightly restrained the opposition parties, labor unions, and NGOs' activities. Even though there were some democratic procedures such as periodic elections and due parliamentary processes, Singapore has been obviously an (competitive) authoritarian state. Elections and electoral rules were used simply as political tools for securing the hegemony of the ruling PAP. Table 21 shows that the PAP government has constructed a solid political platform, securing 54 percent of the total votes in 1959.<sup>89</sup> This dominant position was further strengthened, winning 12 general elections. Truly there has been no meaningful political challenge to the PAP that won about two-thirds of the vote and 95 percent of all seats (Norris 2008, 95). The electoral dominance provided the PAP with a political vehicle not only to limit government commitments to social welfare programs but also to facilitate economic liberalism (Hwee 2002). Indeed, Singapore shows that greatest continuity with its earlier MPW model: strong support for education and vocational training, coupled with minimal public expenditure on redistributive social policies, and the absence of risk-pooling (Haggard and Kaufman 2008, 243).

**Table 21.** Electoral Dominance of the PAP (General Election)

Year	1959	1963	1968	1972	1976	1980	1984	1988	1991	1997	2001	2006
Votes %	54.1	46.9	84.4	69.2	72.4	75.5	62.9	61.8	59.5	61.3	75.3	66.6

*Source:* Election Department of Singapore (<http://www.elections.gov.sg>).

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<sup>89</sup> Election has been the primary channel for the establishment of the PAPs constitutional legitimacy. To claim that people have consented to its policies, the PAP has made efforts to ensure that people vote while installing several institutional obstacles to an effective challenge against the PAP (Tremewan 1994, 181).



To understand the political conditions for Singapore's MPW, it is equally important to see the demand side of the political market—i.e., the people's attitudes toward the PAP. Interestingly, Singaporeans have largely supported the PAP's authoritarian anti-welfare governance. The improved quality of life and remarkable economic growth consolidated political legitimacy of the PAP, engendering a broad ideological consensus between the PAP and the electorate. Economic success, among other factors, was substantial enough to convince the electorate that a political opposition would be just damaging and therefore unnecessary (Tremewan 1994, 158). This has, in turn, prevented the rise of pro-democratic mindset (let alone any movements) in Singapore. As a result, the PAP has been able to rule Singapore for a long time without sizeable oppositional forces, receiving high levels of electoral mandate in successive general elections.

Several survey results confirm this pattern. According to several studies based on the Asian Barometer Survey that was conducted in 2006, Singaporeans were generally in favor of a democratic political system ("very good" 35.6 percent and "fairly good" 55.3 percent) and did not tolerate a dictatorship ("bad" 79.7 percent) or military form of governance ("bad" 72.9 percent) (See Table 22).<sup>90</sup> Despite a general consensus among the citizens with respect to their preference of democracy, however, they were actually open-minded toward "a system that decisions are made by experts according to what the experts think is best for the country." This relatively conservative political orientation suggests that Singaporeans would support the incumbent government as long as they feel like the leadership is able and effective in managing domestic affairs even though it has some nondemocratic features.

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<sup>90</sup> The Asian Barometer Survey, a comparative survey of democratization and value change across the region, was launched in 2000 under the name East Asia Barometer, on the initiative of Yun-han Chu at National Taiwan University and Takashi Inoguchi at Chuo University (Japan). Six consecutive annual surveys have been completed in 27 countries until 2008. Singapore was involved in 2004 and 2006 as part of the survey project.

**Table 22. Preference of Government System**

	% of respondents		
	Very good (%)	Fairly good (%)	Bad (%)
Governance by a powerful leader without the restriction of parliament or elections	4.1	16.2	79.7
A system whereby decisions affecting the country are made by experts (such as bureaucrats with expertise in a particular field) according to what the experts think is best for the country	10.5	48.8	40.8
Military government	4.2	22.9	72.9
A democratic political system	35.6	55.3	9.1

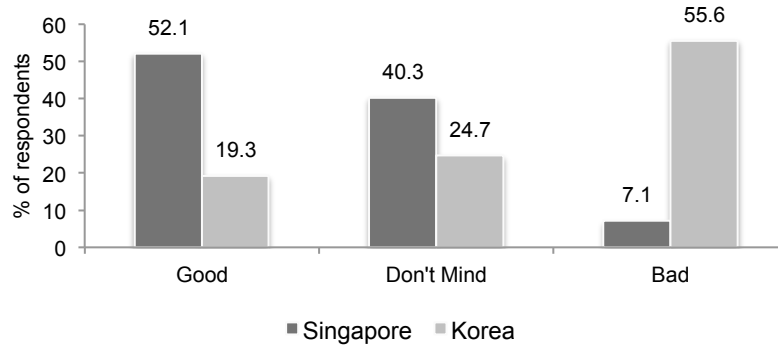
*Source:* Asian Barometer Survey Data 2006 (<http://www.asianbarometer.org>)

*Note:* The number of respondents in Singapore is 2000. The survey question is “Indicate for each system whether you think it would be very good, fairly good, or bad for this country.”

Singaporeans’ conservative political attitudes appear starker when comparing with the responses of Koreans. The World Value Surveys (WVS)<sup>91</sup> asked respondents whether they think “greater respect for authority’ would be a good thing or not.” The results displayed in Figure 23 show that, while 56 percent of Korean respondents thought greater respect for authority would be bad, only 7 percent of Singaporean respondents thought so. 52 percent of respondents believed that respect for authority would be a good thing in Singapore. By contrast, fewer than 20 percent of Korean respondents answered it is good.

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<sup>91</sup> Inglehart and other social scientist developed the WVS to assess the sociocultural, moral, and political values (Inglehart and Welzel 2005). During the past decades, the WVS has extended covering many states in Eastern Europe, Latin America, and Asia.

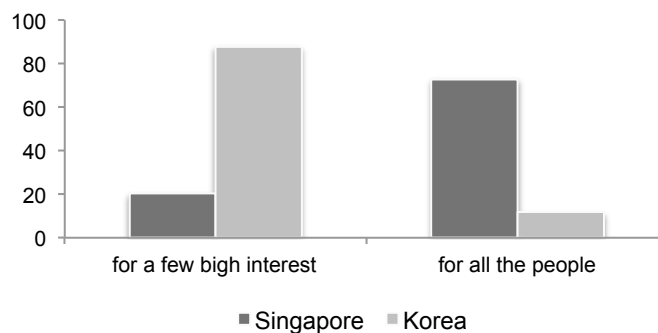


**Figure 23.** Respect for Authority in Singapore and Korea

*Source:* The World Value Survey

*Note:* Korea (2001); Singapore (2002)

For general perception of inequalities, the WVS asked, “Generally speaking, would you say that this country is run be a few big interests looking out themselves, or that it is run for the benefits of all the people?” As expected from the high level of political conservatism, more than 70 percent of the Singaporean people expressed a positive view of their society. By contrast, fewer than 12 percent of the Korean people believe the society is fair, and nearly 90 percent of respondents answered that the country is run by a few big interests (Figure 24).

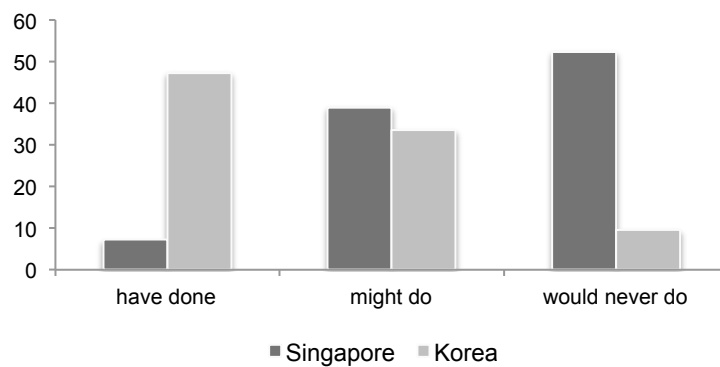


**Figure 24.** General Perception of Inequalities

*Source:* The World Value Survey

*Note:* Korea (2001); Singapore (2002)

The WVS also asked respondents whether they had actually done political action like signing a petition or attending lawful demonstrations, and whether they might do or would never do such actions under any circumstances (Figure 25). In Korea, roughly half of respondents had participated in political action, and 34 percent answered they would do. However, more than 90 percent of Singaporeans had never participated in political activities and, somewhat surprisingly, more than half of them said that they would never do such a thing.



**Figure 25. Involvement of Political Action**

*Source:* The World Value Survey  
*Note:* Korea (2001); Singapore (2002)

The Asian Barometer Survey also shows similar results (Table 23). To the same question, Singaporeans appeared less passionate in their involvement in political action. Signing a petition was the only one that a third of the respondents (31.7 percent) might consider participating in, while a very small number (5.1 percent) had ever actually signed petitions. Also, a majority of the people responded that they would neither join in boycotts (82.5 percent) nor attend demonstrations (77.6%). Indeed, a very small number of the respondents (0.3-0.6 percent) had

such experiences. Singaporeans consistently ranked lowest, compared to Korea (10.7 to 29.9 percent) and Japan (2.1 to 43.5 percent).

**Table 23.** Involvement of Political Action in East Asia

% of respondents

	Singapore	China	HK	Japan	Korea	Taiwan
Signing a Petition						
(a) Have done	5.1	5.5	30.4	43.5	29.9	6.4
(b) Might do	31.7	59.6	31.7	37.9	38.0	22.9
(c) Would never do	55.1	24.5	37.0	14.7	25.7	69.4
Joining in Boycotts						
(a) Have done	0.3	1.8	3.8	2.1	10.8	3.0
(b) Might do	8.2	53.3	32.0	34.7	44.2	14.7
(c) Would never do	82.5	33.8	61.2	53.9	38.7	79.9
Attending Lawful Demonstration						
(a) Have done	0.6	4.2	7.7	4.1	10.7	3.0
(b) Might do	12.2	49.6	30.7	32.4	50.8	11.9
(c) Would never do	77.6	33.2	59.4	54.3	32.6	82.7

*Source:* Asian Barometer Survey Data 2006 (<http://www.asianbarometer.org>); Kuan, Jiuan, and Keng (2010).

*Note:* The number of respondents in Singapore is 2000.

These survey results help us figure out how effectively the PAP has been able to maintain the ideological legitimization of its authoritarian liberalism. When Singapore became independent from Britain, social infrastructure was undeveloped and housing conditions were poor. The economy was plagued with widespread unemployment and social unrest. In this circumstance, it was not difficult to draw a consensus among the mass public on the desperate need of foreign capital for economic development. Removing egalitarian discourse of labor activism, the PAP depoliticized non-government labor unions. Singaporeans also recognized that it was important to integrate Singapore into the world capitalist order and for which they needed to adopt market-

oriented policies. As a consequence, the PAP could create a political and economic environment attractive to business.

Although Singapore has been ranked far more positively—compared with Korea—on Kaufmann measures of government effectiveness, political stability, regulatory quality, control of corruption, and rule of law, it has remained basically dictatorial both in parliament and in government, as seen in the lack of effective checks and balances from opposition parties and the strong control of the press and news media (Norris 2008, 97). Nevertheless, a “survival instinct” that was widespread among the mass public shaped the adaptive political attitudes of the people and which in turn paved the way for the authoritarian rule with anti-redistributive social policies. In other words, the high level of political trust (or compliance) on their authoritarian regime enabled the PAP to develop social security institutions such as the CPF in the accordance of market-oriented productivist welfarism.

Until now, I examined the economic and political conditions for the development of IPW in Korea and MPW in Singapore. Unlike these two cases, China developed a dualist pattern of PWC, combining both social insurance and individual savings schemes. Whereas Korea and Singapore have pursued a nationwide unitary social security system in either more inclusive or more market-oriented ways, the Chinese leadership largely focused on a decentralization strategy coupled with different social security programs for different regions/sectors. This fragmented characteristic of social security system shaped China’s DPW. The next section will examine this.

#### 4.4 CHINA

Since 1978, China has undergone a fundamental economic reform, gradually transforming from socialist economy to market economy. The socialist welfare system, which was an integral part of the socialist economy, has also experienced dramatic changes. Those changes coincided with China's rapid economic integration into the international market. This, in turn, has substantially affected the social policy reform, shaping the Chinese version of PWC. The new orientation of China's social policy stressed two points. The first is to "support for market-oriented economic reform through the enhancement of productivity," and the second is to "stabilize the society via the mitigation of social tensions" (Ministry of Labor and Social Security 1999, 4-7).

As some scholars argue that increasing exposure to international markets reduces welfare programs, Chinese workers have lost a substantial portion of welfare benefits that they had enjoyed in Mao Zedong's socialist China. In this regard, it may be reasonable to consider China as a typical example of the "race-to-the-bottom (RTB)" effect. Many believe that the retrenchment of socialist welfare benefits is the result of China's integration into the world economy (Leung 2003, 77-78).

However, it is not that simple to define the nature of China's welfare transformation because China paints a dualistic picture. First, China has developed a mixed productivist welfare system, integrating "risk-pooling" social funds and "self-reliance" individual savings simultaneously for its pension and healthcare programs. The Chinese leadership believes that a multi-pillar structure that combines social funds and individual accounts can be an effective and efficient way to weave a social safety net while transferring a greater portion of financial responsibility to individuals.

Furthermore, the multi-pillar system of pension and health programs is implemented in different regions differently, exacerbating the urban-rural division. Rural residents have witnessed a collapse in socialist welfare arrangements since the disintegration of the collective economy in the early 1980s. However, no specific system has been developed to meet the needs of local residents, mainly because of the reduction of government financial supports and the limitation of local funds. As a result, rural areas have undergone the de facto privatization of welfare services. By contrast, the newly designed multi-pillar model came into being mostly in urban areas, requiring contributions from both employers and employees who are eligible for pension, medical, and unemployment benefits. The primary purpose of social security reform was to actually protect urban workers who were considered strategically important for economic growth and political stability, so the regional cleavage was not a surprise.

Thus China is undergoing a transition from the centrally controlled socialist system to dualist productivist welfare (DPW), fostering both IPW and MPW with urban-rural divisions. In many dimensions, China's dualist approach is distinguished from the unified systems of Korea (IPW) and Singapore (MPW). Why then does the Chinese government pursue the dualist social security system in spite of its remarkable market reform? After describing the institutional features of China's DPW, I will address this question focusing on China's decentralization strategy of economic reform, the traditional commitment of the Chinese Communist Party (CCP) to industrial workers in SOEs in urban areas, the threat of labor unrest by laid-off workers, and different political attitudes between urban and rural residents.



#### **4.4.1 Development of the Dualist Productivist Welfare Capitalism**

##### **4.4.1.1 Welfare Reform in the Post-reform Era**

Prior to 1978, the Chinese welfare system developed in a socialist context with the following features (Shou 2010, 97-100). First, the socialist system provided comprehensive welfare benefits including healthcare, education, housing, elderly care, childcare, and the likes, based on non-contributory labor insurance. Ideological orientation and political control reinforced the generosity of welfare benefits on the one hand and formed rigid labor market institutions on the other hand.

Second, the cornerstone of the socialist economy in urban China was state-owned enterprises (SOEs) wherein economic production was integrated together with social protection. Each individual enterprise paid employees' benefits of various welfare services, and the government bore the full responsibility for the enterprises' finance. In rural areas, People's Communes in which farmers collectively owned farmland were the basis of economic production and social protection. Due to the interconnected structure of production and social security, public enterprises in urban areas and collective organizations in rural areas carried tremendous financial burdens.

Third, the Chinese welfare regime was known as egalitarian, but in fact it was highly stratified in spite of the socialist claim of universal coverage. During the pre-reform era, comprehensive welfare provisions such as pensions and free medical care were provided unequally in favor of large SOEs that concentrated on heavy industries. While SOEs were at the top in terms of benefits, other urban residents had much less and the farmers were at the bottom. Individuals' welfare benefits thus depended on their job status and residential location.

All these features contributed to the intensification of the government's financial

problems, generating a dramatic increase of the overall number of welfare beneficiaries. With the introduction of market-oriented economic reform in 1978, the socialist welfare system came under severe criticism. The main target of criticism was the “iron rice bowl” (*tie fan wan*, “socialist job security”) that was believed to hinder the promotion of economic productivity and work incentives. Particularly, policy makers expressed their deep concerns about SOEs’ ever mounting welfare burdens and escalating losses. Although one third of SOEs were losing money and 20 percent of their employees were redundant, 97 percent of the SOE workforce were “fixed workers” remaining in their work unit for life on the eve of the economic reform era (Lee 2005, 6; Leung 2005, 51).

Employment guarantees were finally removed in 1986 when the government introduced a market-oriented labor contract system and the Enterprise Bankruptcy Law in urban areas. Since then, the decline in the proportion of SOEs in the economy became evident while private and foreign-owned firms mushroomed, especially during the 1990s when the government made a decisive push to let go of unprofitable small and medium-sized SOEs (Naughton 2007). As the government downsized many SOEs and launched contract-based employment, lay-offs became commonplace. Also, SOEs began to bear full responsibilities for their own profits and losses.

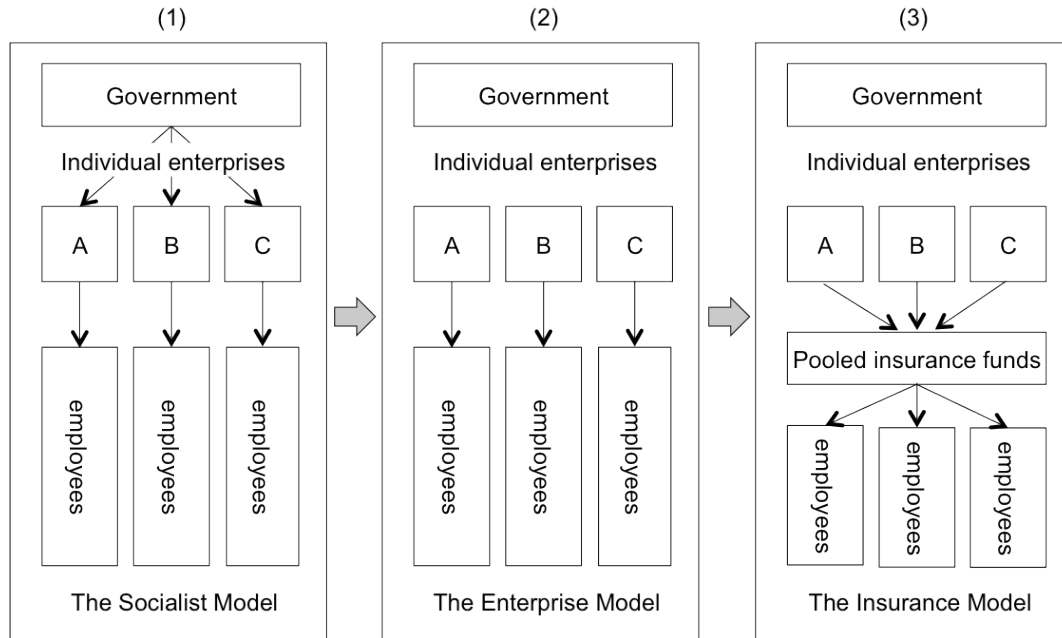
Under this new circumstance, welfare system underwent dramatic changes from the work-unit-responsibility system (on behalf of the state) to a contribution-based insurance system. Those changes rested on two basic principles (Guan 2005, 238). The first was to increase economic efficiency and market competitiveness by cutting off the overall expenditure of welfare. The second principle was to maintain sociopolitical stability by providing an effective

safety net for the workers.<sup>92</sup> Based upon these seemingly contradictory principles, the general trend of social welfare reform moved toward a dualist system, combining diversified funding sources and welfare responsibilities. Instead of the traditional government-sponsored pension and health programs, the Chinese government developed a risk-pooling system as a main tool to transfer the financial burden of social security to individual firms and their employees (Smuthkalin 2006, 203).

Figure 26 illustrates the basic process of welfare system reform in China. It shows how policy makers deliberately changed the social welfare system over time to achieve the goal described above. Before the economic reform, each individual enterprise paid employees' benefits of pensions, medical treatment, etc., and the government took the full responsibility for the enterprises' finance (1). During the initial period of economic reform, the government stopped the financing of social welfare while individual enterprises still had to pay (2). To deal with the funding issue, the focus of reform shifted once again to the creation of a pooling system (3).

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<sup>92</sup> In rural areas, the commune system was also collapsed in 1983, putting the collective welfare system in complete disarray. As the market-oriented reform has accelerated, it became apparent that the individual family in rural areas should bear the responsibility for protection against social contingencies and consequently has become more vulnerable to the risk of any loss of income.



**Figure 26.** The Welfare System Reform in China

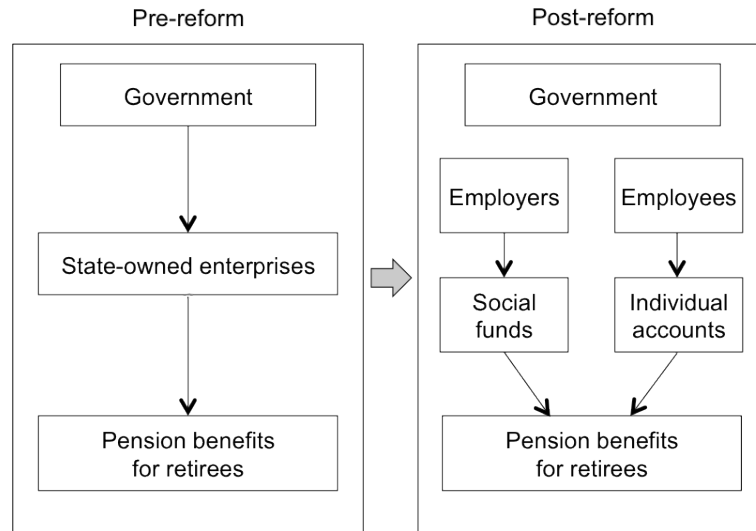
*Source:* Guan (2005, 239)

#### 4.4.1.2 Pension Insurance

When Deng Xiaoping launched economic reforms in 1978, the State Council issued a new pension regulation, entitled “Provisional Regulations for Retirement and Early Retirement of Workers” (Document No.104), that called for enterprises to bear financial responsibility individually. But the problem was the inequality of the pension burden between new firms in relatively prosperous regions with a young workforce and old firms where the ratio of pensioners to active workers reached 50:50. To solve this disparity problem, the State Council issued Document No.77 in 1986, establishing a pooling system across SOEs on a limited basis at the municipal level. The pool was financed with a predetermined rate of contribution from enterprises, and these enterprises were responsible for distributing the pension benefits. If the pension expense of an enterprise was less than the contributions, the difference was remitted to

the pool. If pension expenses were higher, the pool would cover the difference. Thus, the concept of redistribution of income via risk-pooling was the initial idea of the pension system reform (Leckie and Pai 2005, 28-29).

In 1991, the State Council issued another regulation (Document No.33), calling for the expansion of pooling system and the establishment of three pillars in the pension system—which consisted of (i) a mandatory social insurance pillar (DB) to provide a basic benefit from pooled funds, (ii) a mandatory individual savings pillar (DC), and (iii) voluntary individual savings to supplement the mandatory pillars. As shown in Figure 27 and Table 24, the multi-pillar pooling system had three important features (Guan 2005, 243). First, employers and employees shared the financial responsibility together. Secondly, in the new system, the contributions from employers and employees went to two separate accounts: the social pooling fund and the individual account. The first tier—social fund—works on a pay-as-you-go (PAYG) basis and is financed by employers (20 percent of the employee's wages). The second tier is managed as fully funded individual accounts. This tier was originally financed with contribution of 7 percent from enterprises and 4 percent from individual employees. Yet, in 2006, it began to be funded solely through employee contributions of 8 percent of wages. Thirdly, eligibility for pension was largely limited to urban workers, intensifying rural-urban divisions. Although the new system aimed to cover all urban residents in a single scheme, this goal was never achieved because of the increase in informal employment in the private sector.



**Figure 27.** Pension Insurance System in China

**Table 24.** Contribution and Benefits under the Multi-Pillar Pension Scheme

Pillar	Contributions		Benefits
I	Employer	20% of monthly wage	35% of average monthly wage (if 15 years of employment)
II	Employee	8% of monthly wage	Individual account fund divided by 120 (equal to 24.2% of average monthly wage)
III	Employee	Voluntary	Individual account fund
Total		28% of wage, plus voluntary contributions	59.2% of wage, plus voluntary pensions

*Source:* Salditt et al. (2008, 55)

Since the government adopted the multi-pillar system of social pooling and individual accounts in 1991, the dualist approach has been further amended several times, reflecting local conditions. During 1991 to 1995, the pension system was run by “corrupt and rent-seeking” local governments, so the central government’s efforts to standardize and rationalize pensions were easily thwarted at the local level (Frazier 2010a, 2). In order to solve the policy distortion

problem, the central government issued the State Council Document No.6 in 1995, clarifying the objectives of the reform that focused on the expansion of coverage, the establishment of a multi-level system, and the consolidation of pension administration.

However, although the new policy regulation envisioned the unification of local pension programs at the national level, it did not work as intended. Because the decentralization strategy was the centerpiece of China's economic reform, the central government could not promote and carry out industrialization (and the privatization of SOEs) without giving substantial discretionary power to local governments. In this circumstance, local governments were always tempted to pursue their local interests more than anything else, not only in the economic policy areas but also in the process of the new pension system. Indeed, individual localities interpreted the center's new regulations as something to give more leeway to them to expand the pension system. Furthermore, the nature of the funding requirements made pensions as the most moneymaking source of social insurance revenue for local governments and, hence, local officials were greatly interested in collecting contributions from local enterprises arbitrarily rather than complying with the center's unification efforts (Frazier 2010a, 9).

Because local governments at the city and county levels operated as many as 3,400 separate pension funds by the late 1990s, the central leadership believed that, without further actions, the lack of standardized pension system would cause greater discrepancies across the country. This is why the central government released a new regulation once again in 1997—the State Council's Document No. 26—which aimed to establish a nationwide multi-pillar pension system by replacing all pilot programs and local plans in each province (Leckie and Pai 2005, 30). Due to the center's strong policy commitment, the number of urban workers covered by national pension insurance increased to 218.9 million in 2008. This was 72.5 percent of urban

workforce reported in official statistics. Truly, it was a significant rise from 57.1 million workers who had pension insurance in 1989 (Table 25).<sup>93</sup>

**Table 25.** Population Coverage of Pension Insurance in Urban China

	Contributors (millions) [1]	Recipients (millions) [2]	Total participants (millions) [1]+[2]	Coverage (=total participants)		
				% of total population	% of urban population	% of urban workers
1989	48.2	8.9	57.1	5.1	19.3	33.5
1990	52.0	9.7	61.7	5.4	20.4	30.5
1991	56.5	10.9	67.4	5.8	21.6	32.4
1992	77.8	16.8	94.6	8.1	29.4	43.5
1993	80.1	18.4	98.5	8.3	29.7	43.9
1994	84.9	20.8	105.7	8.8	30.9	45.5
1995	87.4	22.4	109.8	9.1	31.2	45.9
1996	87.6	23.6	111.2	9.1	29.8	44.0
1997	86.7	25.3	112.0	9.1	28.4	41.7
1998	84.8	27.3	112.0	9.0	26.9	39.2
1999	95.0	29.8	124.9	9.9	28.5	42.4
2000	104.5	31.7	136.2	10.7	29.7	45.1
2001	108.0	33.8	141.8	11.1	29.5	45.1
2002	111.3	36.1	147.4	11.5	29.4	44.9
2003	116.5	38.6	155.1	12.0	29.6	45.4
2004	122.5	41.0	163.5	12.6	30.1	46.3
2005	131.2	43.7	174.9	13.4	31.1	48.0
2006	141.3	46.4	187.7	14.3	32.5	66.3
2007	151.8	49.5	201.3	15.2	33.9	68.6
2008	165.9	53.0	218.9	16.5	36.1	72.5

*Source:* National Bureau of Statistics. 2009. *Chinese Statistical Yearbook*. Table 3-1; 4-2; and 22-40.

However, unlike in urban areas, there were few pension provisions in rural areas. Even though a rural pension regulation stipulated three sources of financing ((i) the insured individuals' contribution, (ii) the local communities' subsidies, and (iii) the local government's favorable

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<sup>93</sup> However, the level of pension benefits in urban areas has fallen since 2002, both as a percent of GDP per capita and in relative terms to average SOE wage. While average annual pensions in the 1990s were around 65 percent to 75 percent, this level decreased to 60 percent in 2004 and even less than 50 percent in 2007.



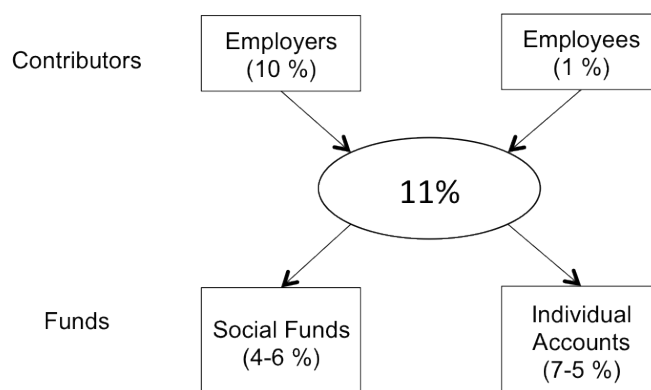
policies such as tax exemption), the rural pension system was essentially an individual responsibility scheme (Shi 2006). The lack of a proper redistribution mechanism caused rural pension system to fail to produce meaningful progress (Salditt et al. 2008, 57). As a consequence, the coverage rate in rural areas declined significantly from 75 million (15.4 percent of total rural labor) in 1997 to 54 million (11 percent) in 2004. Because of the limited scope of the rural pension system, the overall pension coverage rate in China remained as low as 16.5 percent in 2008 (Table 25).

#### **4.4.1.3 Health Insurance**

Prior to China's economic reform, near-universal insurance coverage was provided by the cooperative medical system in rural areas and the labor insurance system in urban areas. The communes in rural areas organized healthcare centers, paid village doctors for their primary care services, and provided prescription drugs. When China reformed the rural economy in the early 1980s by introducing the Household Responsibility System, the People's Communes disappeared and consequently the existing socialist health care system was collapsed. This reform process eventually left the majority of farmers uninsured. In urban areas, healthcare that had been financed by state/collective enterprises during the pre-reform era has also undergone radical changes. Above all, economic reform and decentralization gave rise to a drastic reduction in government revenue, which in turn reduced the capacity of the government to fund healthcare. As a result, government subsidies for public hospitals fell to a 10 percent of total revenues of those hospitals by the early 1990s (Yip and Hsiao 2008, 462).

In order to deal with the rising costs of medical services in the reform era, the State Council organized a multi-ministry committee in 1988 and launched experimental healthcare system reforms. With guidance and support from the central government, pilot programs began

in two cities—the city of Zhejiang in Jiangsu Province and the city of Jiujiang in Jiangxi Province. The so-called “two-jiang” model was a contribution-based health insurance system, combining the Korean style of social risk-pooling and the Singapore style of compulsory savings. In this dualist model, both employers and employees shared the contribution. The former contributed 10 percent while the latter made 1 percent of their total payroll to the health insurance fund. The fund was divided into two accounts as seen in Figure 28.

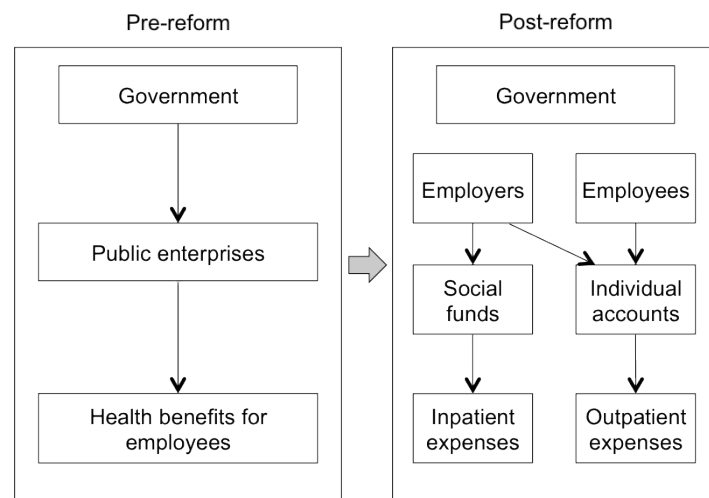


**Figure 28.** Contribution Rates to Health Insurance Funds in the Dualist Model

*Source:* Word Bank (1997, 58).

After nearly ten years of trial and error, the State Council issued a new guideline in 1996, extending the dualist “two-jiang” model to 57 cities in 27 provinces, autonomous regions, and provincially ranked municipalities across the country. And then the government made another decision in 1998 that required all provinces to implement by 1999 a basic health insurance scheme following the dualist model (Gu 2003, 8). The 1998 health insurance system required all employers and employees in urban areas to join a contributory program without exception. The basic structure of two accounts (social risk-pooling funds and individual accounts) was same, but

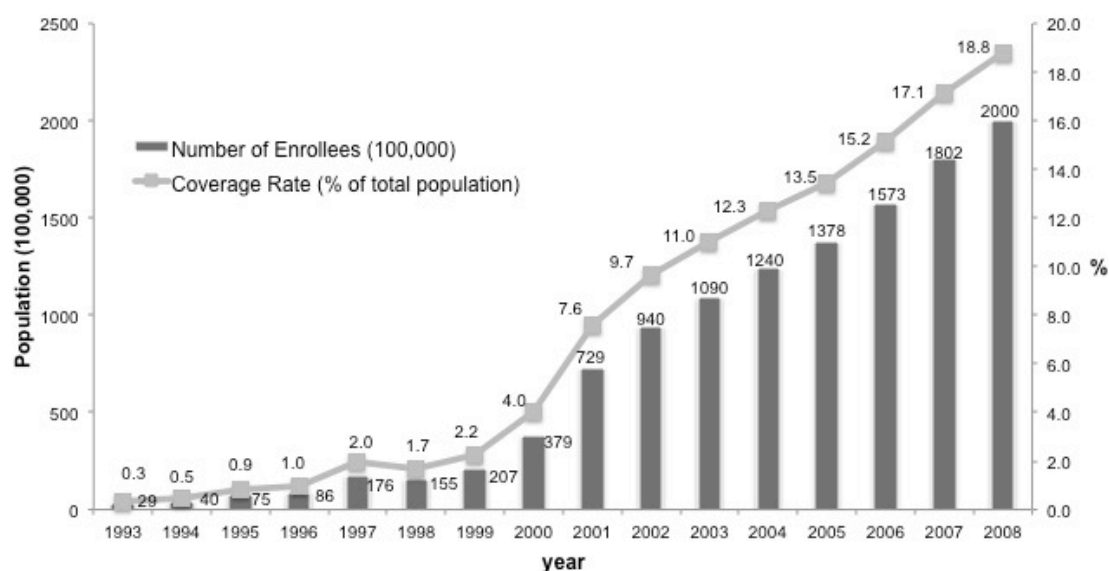
the contribution rates were changed. Since 1998, employers have paid 6 percent of total payroll while employees contributed 2 percent of their monthly salary. Interestingly, the social pooling funds were available only for major illness that required inpatient services whereas employees could spend the fund in their individual account for outpatient services and minor illnesses (Figure 29).



**Figure 29.** Health Insurance System in China

Although the health insurance system looks similar with the pension system in many aspects, they include several fundamental differences. One of them is that the administrative level at which health insurance is implemented is different from that of pension insurance. While health insurance is fragmented into many small local programs at a lower level, pension insurance is organized and supervised at a higher level. This means that there are more local health insurance funds than pension funds, and that China's healthcare system is highly fragmented. Indeed, most health insurance funds were formed at the level of city (*chengshi*) or even county (*xian*), depending on the decision of local authorities (Smuthkalin 2006, 205). Due to this decentralized

administrative structure, a nationwide unitary healthcare system is hard to achieve, and hence it is not a surprise that the coverage rate of the new health insurance scheme is merely 18.8 percent of the population as of 2008, far away from universal coverage (Figure 30).



**Figure 30.** Expansion of Health Insurance in China

*Source:* China Labor Statistical Yearbook (2009).

The situation of healthcare benefits in rural areas is worse.<sup>94</sup> During the reform period, the rural cooperative healthcare system were disbanded and replaced by private health care centers in most villages, which led to the rapid increase of private health expenditure from 20 percent in 1978 to 42 percent in 1993 and even to 53 percent in 2008 (World Bank 1997, 19 and *WHOSIS*). The central government responded immediately, calling for the development of community-based schemes to fund and organize healthcare for the rural sector. Particularly, the government

<sup>94</sup> The central government basically neglected rural health development to a large extent. The amount of public expenditure on health services for rural areas was much less than that for urban areas (Guan 2005, 248).

emphasized that each community should organize its own collective financing for basic healthcare and that funding would be drawn from multiple sources, including local government, collectives, and individuals (Cheung 2001, 83).

However, most provincial and county governments did not comply with the center's instruction because the voluntary community-financed schemes required rural households—that were already suffering from heavy tax burdens—to make substantial contributions to the fund. It is of course necessary to reintroduce a rural health insurance scheme in order to protect rural residents. But all the central government did was to simply issue guidelines without allocating funds for local implementation of the new system in rural areas.

#### **4.4.2 Political Economy of China's DPW**

As examined above, China has developed a complex “dualist” design of productivist welfare system. Undoubtedly, this institutional platform included both IPW and MPW features. Then why did the Chinese leadership introduce and foster the dualist form of productivist welfarism? In the following discussion, I will examine how economic and political factors influenced the Chinese government to advocate the use of a dualist and fragmented pattern of PWC.

##### **4.4.2.1 Economic Contexts**

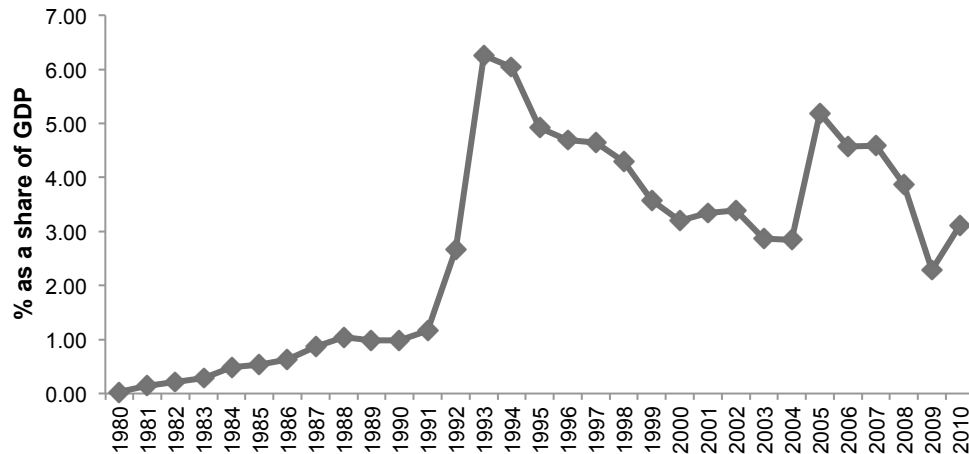
In the late 1970s and early 1980s, China's open-door policy began to establish experimental special economic zones (SEZs) in coastal regions, encouraging local governments to create an economic environment attractive to foreign capital. To a labor abundant (and capital scarce) country like China, the attraction of foreign capital was seen as vital for successful economic reform and growth. Because cheap labor was the most appealing factor of comparative

advantage, both the central and local governments had a strong interest in keeping labor costs and tax rates as low as possible to attract more foreign firms and capital. To this end, the Chinese government lowered taxes on joint ventures and foreign-owned firms. It also reduced social expenditures and loosened labor standards.<sup>95</sup> Thanks to the government's open-door policy and its efforts to attract foreign capital, China became one of the world's most important destinations of FDI.

Foreign capital has poured into China since 1992, and annual inflows have been over 40 billion dollars since 1996, accounting for one third of total FDI inflows of developing countries (Naughton 2007, 401). FDI inflows were not only the largest of all developing countries but also stable and robust despite the recent instability of global economies. Figure 31 shows that, during the 1980s, FDI was merely less than 1 percent as share of GDP, but it sharply increased up to even more than 6 percent in 1993 and 1994. Although inflows were fluctuating between 2 and 5 percent in the 2000s, this figure clearly illustrates that China has been very successful in attracting foreign capital.

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<sup>95</sup> Some scholars argue that trade liberalization and capital flows would rather increase public expenditure as import-competing sectors demand more social protections (Garrett 1998; Hicks 1999; Rieger and Leibfried 2003; Rodrik 1997). According to them, many open economies in Europe expanded social protection programs as part of a political bargain with labor unions over the pursuit of open trade in exchange for more redistributive welfare policies. But this kind of political bargain rarely happens in less developed countries because their intense need for capital makes them be vulnerable to global market pressures (Rudra 2008, 3).



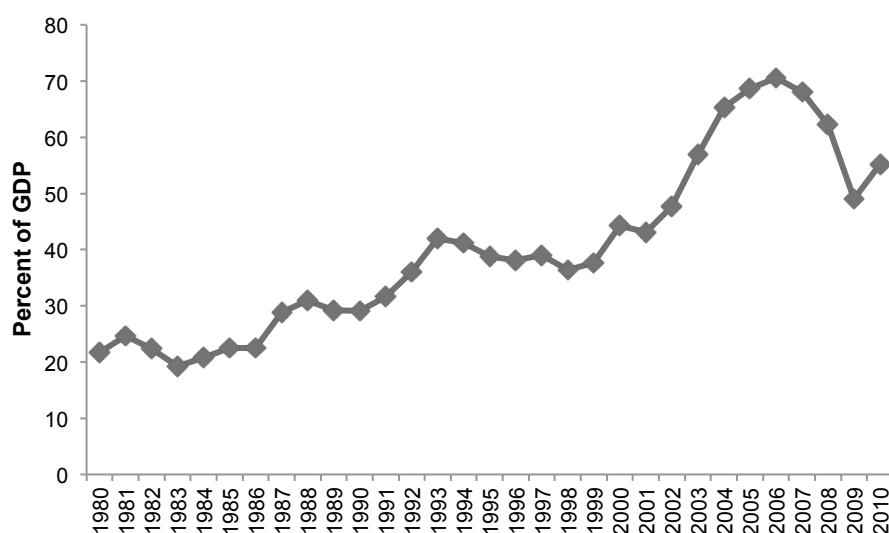
**Figure 31. FDI Inflow in China**

*Source:* World Development Indicators (World Bank).

FDI in China involves three distinctive characteristics (Naughton 2007, 401). First, the principal factor that enabled China to have accessed global capital was neither portfolio capital nor foreign loans but FDI. Second, a large portion of FDI went to not service sectors but manufacturing sectors. Third, investment from Hong Kong and Taiwan was quantitatively most important. Each of these three aspects reflects the dominant role of China as a manufacturing center in East Asia. Indeed, many firms of Hong Kong and Taiwan moved much of their manufacturing to the mainland, employing approximately 10 million workers in China (Wan 2008, 209). In addition to job creation, FDI brought management experiences, marketing channels, and technology. Thus the influence of foreign capital in China was so enormous that the government often rewrote the existing rules and laws of labor relations and associated welfare programs in favor of foreign investors.

Another important economic change in China was the liberalization of trade system. Before 1979, trade did not exceed 10 percent of GDP. However, in 1978, China began to take

modest but groundbreaking steps in southern provinces, opening up a new course of trade relations. Since then, trade liberalization has become an integral part of economic reform, and China successfully converted its system from an isolated socialist economy to a “socialist market economy with Chinese characteristic.” As seen in Figure 32, China’s total exports and imports have increased considerably, amounting more than 70 percent of GDP in 2006.



**Figure 32.** Trade in China

*Source:* World Development Indicators (World Bank).

Looking back, China’s strategy was a correct one. However, given the political and economic risks that the transition to a new capitalist system might cause, the central leadership could not be fully committed to a full-fledged open door policy at the beginning. So the Chinese government established special economic zones (SEZs) in Guandong and Fujian in 1979 and gradually proliferated SEZs of various kinds during the 1980s and 1990s. The central government used



SEZs as a test bed for domestic economic reforms, allowing local officials to implement policies in a way to maximize positive outcomes of economic reform.

In this process, local governments could obtain considerable policy autonomy from central decision makers (Frazier 2010a, 21). Particularly, the decentralization strategy gave rise to significant changes in fiscal arrangements between the center and local units. Local governments at various levels (city, county, and province) were given greater incentives and responsibilities from the center regarding their rights to revenue from local economic activities (Shirk 1993). The fiscal and administrative decentralization created fragmented and overlapping regulatory authorities in several policy areas (Lieberthal 2004), providing local governments with strong incentives to attract foreign capital into their region even beyond the statutory concessions (Naughton 2008, 411).

Economic liberalization thus made important contributions to the widening economic opportunities among regions, local governments, and local firms that competed for FDI inflows for their local benefits. Such competitions for foreign capital in turn facilitated the fragmentation of national governance, making it hard for the central government to monitor local officials effectively (Gallagher 2002). More importantly, the fragmented and decentralized system allowed foreign investors to play localities off against each other in search of favorable measurements in taxation, land use, and foreign currency exchange (Zhang 2008). In other words, the decentralization strategy of economic reform gave local governments greater discretionary power, which used to distort the center's economic and social policies.

The diffusion of authority and its impact on local interests became more prominent when the central government introduced a labor contract system and bankruptcy law in 1986. Before the economic reform, each work unit (SOEs in urban areas and People's Communes in rural

areas) functioned as a “self-sufficient welfare society” that provided individuals’ employment, old-age income security, housing, food, education, healthcare, and the likes. Even after the economic reform was launched, the welfare burdens of work units were still increasing as the number of retirees rose.<sup>96</sup> For example, pension payments of SOEs increased from 5 billion yuan in 1980 to 39.6 billion yuan in 1990 and to 242 billion yuan in 1999 (Leung 2003, 77-78). To deal with this problem, the Chinese government set out labor contracts and bankruptcy law, with a purpose to alleviate the tremendous financial pressure caused by the socialist legacy of employment and welfare benefits. More fundamentally, the reduction of labor/production costs was one of the necessary conditions for foreign capital inflows, so the Ministry of Labor and Personnel started the labor contract experiment in 13 provinces and expanded it later to all provinces. The creation of flexible labor markets was a great incentive to local officials and factory managers because they could exercise their discretionary power arbitrarily in the labor market to attract more foreign investment (Lee 2005, 6-7).

Certainly the removal of the formerly rigid labor market resulted in the increase of foreign investment. However, it also produced massive layoffs of workers.<sup>97</sup> Although the Chinese government restructured the existing employment system and eliminated socialist welfare benefits to enhance market efficiency, it had to reweave a new social safety net in order to prevent any negative impacts that might be caused by economic reforms. The new social

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<sup>96</sup> The number of retirees skyrocketed from 3 million in 1978 to 16.4 million in 1985 and even to 37.2 million in 1999.

<sup>97</sup> By 2001, there were 7.69 million “laid-off” workers and 6.19 million “unemployed” workers. A “laid-off” worker is one who began working before the labor contract system was adopted in 1986 and was unemployed because of his/her firm’s problems in business. An “unemployed” worker is one whose firm officially declared bankruptcy. Many workers who lost job when their firms collapsed without going through the official bankruptcy procedure cannot be registered as unemployed workers. Therefore, official statistics (around 3-4 percent) are generally considered inaccurate. Many studies report that the true unemployment rate is 3 to 4 times higher than official rates (Lee 2005, 13).

security system accordingly had to be in a way to grasp both market efficiency and social stability simultaneously.

Multi-pillar insurance was a kind of social security arrangement the Chinese government was seeking. First, because risk-sharing was normally financed by joint contributions from employers and employees, the central government was able to transfer welfare responsibilities to local governments, and local officials could in turn reallocate the burdens to firms and employees, strengthening the commodification of major social services. The individual savings component could also enhance the market-oriented nature of the new social security system. Secondly, a social insurance system, as opposed to a work-based lifetime welfare system, could propel labor mobility because the new system was no longer tied down to specific workplaces (Wong 2001, 43). Thirdly, a contribution-based system was highly favorable to local governments that were experiencing serious revenue shortfalls caused by the center's decentralization of fiscal responsibility. Because the establishment of social insurance programs meant that a large amount of money could flow into the local governments, social insurance was a highly preferred method at the local level.

Truly, local governments used pension and other social insurance funds for local economic projects that would otherwise be funded by tax revenue. For example, it was reported in 2006 that the Shanghai government had implemented its own pension funds for more than 10 years to make an estimated 33 billion yuan (\$4.2 billion) in loans to local developers (Frazier 2010a, 12; 90-94). If we look at the main sources of revenues of local governments, we will be able to understand how important it is to local governments (Table 26). In 2005, the average pension insurance revenue of local governments amounted to 509 billion yuan, exceeding all the other tax revenues. It is not unreasonable to think from this statistics that local governments

relied on social insurance funds more than business taxes to cover their responsibilities of public expenditures.

**Table 26.** Fiscal Revenues of Local Governments (2005)

Category	Amount (billions of yuan)	% of Total Fiscal Revenues
Pension insurance revenue	509.3	34.2
Business tax	410.3	27.6
Value-added tax	264.4	17.8
Enterprise tax	174.6	11.7
Administrative fees	107.4	7.2
Personal income tax	83.8	5.6

*Source:* Frazier (2010a, 92).

Certainly, local governments viewed the social security reform as a strategic route to raise fund reserves whereas the central government aimed to expand a uniform, multi-tiered insurance system to cover as many workers as possible in urban areas. This different motivation between the center and localities generated not only difficulties in policy implementation but also a critical dilemma on the part of the central government. In general, the expansion of social insurance schemes requires a sophisticated monitoring system to collect the contributions. But it is actually impossible to construct such a monitoring system without giving away the center's control to local agents, especially in big countries like China. It is so because local authorities can more effectively monitor and regulate thousands of local insurance agencies that collect revenues from firms and individuals. That is, in the decentralization context, the expansion of social security system is largely dependent on local governments that are "ready" to distort the center's policy intention.

To resolve this dilemma, the central government has embarked on a series of pension and health insurance reforms, establishing a national system in hope of taking control back over the fragmented funding pools, management organizations, and different contribution rates and benefits (Leung 2003, 84). Nevertheless, however, China's social insurance system has still been largely decentralized and segmented (Cheung 2001, 80). Access to benefits is not uniform across occupational groups, economic sectors, geographical regions and residential status. Especially, rural areas have been largely isolated even in the new system because the focus of economic reform and liberalization has been on urban China.

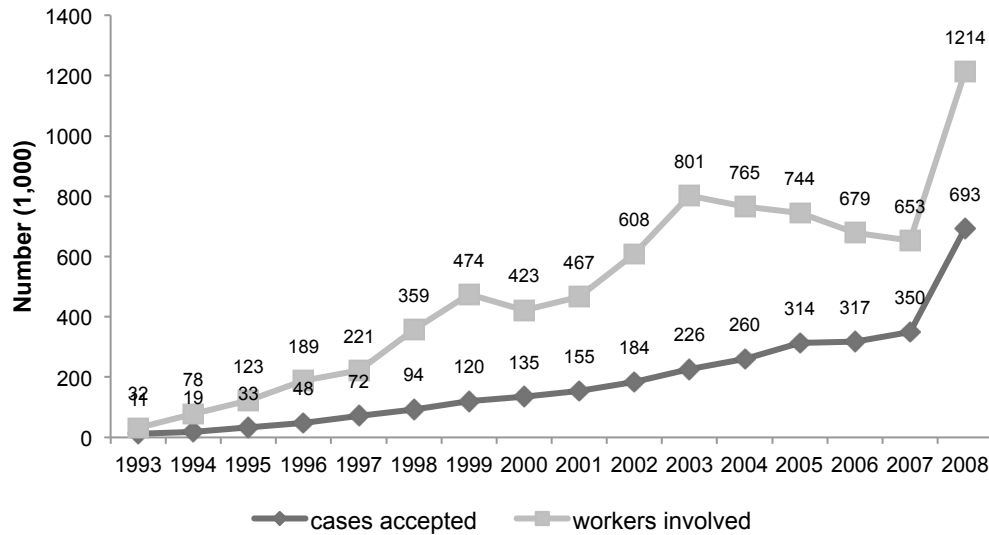
In short, China's economic liberalization and massive FDI inflows made the traditional work unit-based socialist welfare system inadequate and inefficient. At the same time, the market-oriented reform has generated a wide array of social problems such as massive unemployment, income insecurity, and the increase of healthcare costs. Facing these challenges, the central government has been trying to reweave a new social security system in hope of achieving both market liberalization and social stability. Its new multi-tiered contributory schemes are believed to be compatible with the two conflicting goals, though there is a tough road ahead.

#### **4.4.2.2 Political Contexts**

As examined above, economic liberalization and reform policies have driven the Chinese government to develop a dualist combination of risk-sharing and individual savings for old-age pension and healthcare. Yet China's dynamic political context is also an important background that has influenced the development of DPW in China. It includes (i) the rise of labor disputes and (ii) the fragmented political attitudes between urban and rural residents toward the government's new social policy approach.

The rise of a new social security system in China has occurred together with new forms of political demands and attitudes of the people toward government. Although capitalism has become increasingly practiced in China along with the adoption of labor contract system, the Chinese government could not entirely commodify labor-management relations because of the “socialist contract” that the Chinese Communist Party (CCP) had promised to provide basic welfare benefits in exchange for loyalty and services (Smuthkalin 2006, 209). However, in its decentralization strategy, the central government could not effectively monitor how local government and firms carried out the socialist contract without a critical violation of the retired workers’ right of pension and healthcare benefits. Consequently, urban workers who lost their jobs and benefits were generally treated unfairly in the midst of the SOE reforms in the 1990s, and they used various forms of protests to vent their anger over the broken promises of the CCP (Hurst and O’Brien 2002). The increase of labor disputes triggered by the anger was explosive enough for the central leadership to view it as a major threat to social and political stability.

As shown in Figure 33, the number of labor conflict remarkably increased in urban areas throughout the 1990s and 2000s. Forms of conflict included legal proceedings (e.g., mediation, arbitration, and lawsuit) and informal means (e.g., everyday workplace resistance, petitions, work stoppages, strikes, and public protests) (Lee 2000, 41). In fact, it is impossible to gain accurate data for all or even some of these types of dispute. But, Figure 33 suggests at least that the number of labor disputes referred to arbitration committees at all levels increased dramatically over the period of 1993-2003 across the country. In particular, the number of workers involved in labor disputes increased from 221,115 in 1997 to 801,042 in 2003, a rise of 3.6 times just in six years. Given that many labor disputes were not applicable for arbitration, the number of actual labor disputes would be much greater.



**Figure 33.** Labor Dispute Cases Accepted by Arbitration Committee

Source: China Labor Statistical Yearbook (2009)

According to several survey-based studies, social insurance was one of the leading causes, making up over 25 percent of the total number of cases. It was reported that the number of labor disputes involving social insurance and welfare rose up to 34 percent in 2004 (Chen 2003; Tang 2005; Kim 2010).<sup>98</sup> However, we should remember that such disputes were neither an expression of resistance against social security reform *per se* nor a desire for the return to the socialist way of equal redistribution. Although a majority of respondents (72 percent) in a nationwide survey felt that the income gaps and inequalities increase in China, only 40 percent of them replied that

<sup>98</sup> According to an online survey (nearly 400,000 responses) conducted in 2009 by the Sociology Institute of the Chinese Academy of Social Sciences and *Guangming Daily*, a majority of the Chinese people believed that social security is one of the most serious problems in China. When the respondents were asked to rank the three social problems to which they paid the most attention, social security (58.1 %) was second behind corruption (66.8%) and ahead of income inequality (57.7%) (Frazier 2010b, 265-266).

local income differences are serious.<sup>99</sup> Other inequality-related questions in the same survey also showed that a majority of the respondents disagreed with an egalitarian distribution of income or benefits (Whyte 2010, 131-133). These responses suggest that Chinese citizens are striving for social justice but not in a way that sets limits on the income and wealth of the rich or redistributes from the rich to the poor. Rather, the Chinese people are more concerned about the widespread rent-seeking and corruption of local bureaucrats at a lower level of government. In other words, the workers' anger was rather an expression of grievances against local officials and SOE managers for their inability, corruption, and failure to provide urban workers with job security and social welfare benefits (Frazier 2010a, 28).

In response to the uprising protests, the central government initially allowed local authorities to use funds from the newly established personal savings accounts of current workers to pay pension and healthcare benefits for retired SOE workers. Local governments also spent more on pension and health benefits for approximately 50 million retired factory workers and 12 million civil servants than they do on education, local construction, public security, or any other budgetary categories.<sup>100</sup> This approach might work in the short run, but it could not be a long-term policy due to the funding problem. So the central leadership decided to provide subsidies to provinces and cities that have chronic shortfalls in social insurance revenues. Yet the provision of subsidies might undermine the initial social policy thrust that avoid the people's reliance on state support for social security. For this reason, the central government shifted its policy focus to the unification of local social insurance programs through which to encourage urban workers

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<sup>99</sup> This statistical data comes from the 2004 National China Survey on Inequality and Distributive Justice that was conducted by a collaborative research team consisting of Albert Park (Oxford University), Pierre Landry (University of Pittsburgh), Wang Feng (Texas A&M University), and others.

<sup>100</sup> They spent about 404 billion yuan (\$49 billion) in pension benefits in 2005 and 490 billion yuan (\$59.5 billion) in 2006 (Frazier 2011, 64).



share their risks and funds on the one hand and save individual financial assets for social security on the other hand. The center believed that the expansion of unified social security programs would promote transparency as well as efficiency of the social safety net.

The center's prompt policy response seemed to work positively in gaining political support from the mass public in China. Table 27 shows, when respondents were asked in a survey about the degree of trust with regard to pension administration, a majority (84.5 percent) answered that they somewhat or very much trusted the central government to administer pensions. The similar number of respondents (85.2 percent) also considered local governments positively.

**Table 27.** Trust in the Government's Pension Administration

	Very much mistrust (%)	Somewhat mistrust (%)	Neutral (%)	Somewhat trust (%)	Very much trust (%)
Central gov't	1.7	6.6	7.3	59.7	24.8
Local gov't	1.3	12.8	10.6	62.4	12.8

*Source:* Frazier (2010a, 152).

*Note:* The 2004 Beijing Areas Study (n=593).

Somewhat interestingly, the central government has been enjoying a remarkably high level of popular support in spite of the increasing income gaps, labor disputes, and the 1989 Tiananmen Square Incident. Because the overwhelming majority of the general public believes that they are on a right track of marketization reform, they are basically supporting the CCP although they sometimes reveal their dissatisfaction toward the government. In a 1995-99 survey of Beijing residents, nearly half of the respondents expressed "strong support" for the CCP-led regime (Chen and Zhong 1997). Similarly, in a survey conducted in 6 cities in 1999, Tang (2005) found

that 45 percent of the respondents did not want changes in the current regime, and that 30 percent did not care about the nature of the regime as long as their lives could be improved. Indeed, this pattern of positive responses has been found in almost all nationwide surveys conducted over the last decades (Wright 2010, 14).

This deep-seated conservative political attitude among Chinese citizens indicates that, despite a marked upsurge in labor unrest, public pressures for systemic political change have been virtually insignificant. Given the pro-government nature of the general population, it is not unreasonable to expect that public support for the CCP regime would remain high, as far as the central government embarks some measures to deal with social problems while the economy grows. In this sense, a multi-tiered social insurance system is a good strategy for China's dualist goal. First, the new social security system could be used as a "safety valve" through which the government could let off the steam of labor unrest and discontents in urban areas. Second, by incorporating a social fund component with an individual savings component into one scheme, the government could pursue two seemingly conflicting goals (risk sharing and self-reliance) simultaneously. As such, (i) the rise of labor unrest and (ii) the people's support for the CCP have provided a political background that shaped China's dualist approach to productivist welfarism (although policy implementation has been often distorted at the local level).

Another feature that draws attention is the significant difference in political attitudes between urban and rural residents that has influenced the regional cleavage of China's DPW. In general, disadvantageous groups like farmers and migrant workers may be more likely to express their discontent and protest rigorously for fair compensation. Because farmers' socioeconomic status has declined sharply throughout the reform era, China's peasants should be a greater threat to the political stability of the CCP. For example, the urban-rural income gap grew from 2.1:1 in

1990 to 3.3:1 in 2007 (*Chinese Statistical Yearbook* 2009). Surprisingly, however, Chinese farmers show a higher level of regime support. Despite a long history of rebelliousness stemming from material disparities, today's Chinese peasants have shown remarkably little proclivity toward challenging the existing state-led welfare reform. Although farmers have often demonstrated great contempt for local officials, they still express significant trust in the central government (Wright 2010). Even when they have engaged in protest, they have appealed to national leaders to enforce what in their view are benevolent and well-intentioned laws and regulations. According to O'Brien and Li (2006)'s survey, 78 percent of rural respondents agreed that, "the Center is willing to listen to peasants who tell the truth and welcome our complaints," and 87 percent agreed that, "the Center supports peasants in defending their lawful rights and interests." Obviously, this is a myth because, compared to urban residents, the state-led social security reform has brought farmers' social security down to the market. Of course, the Ministry of Labor and Social Security (MLSS) had a division to take care of rural pension programs. However, the officials did not pay much attention to them and eventually discarded most rural programs (Smuthkalin 2006, 215).

Wright (2010, 150-151) explains the distinctive political attitudes of farmers, focusing on the combination of market reforms, agricultural decollectivization, and the loosening of migration restrictions. Indeed, although most of peasants in China remain near the bottom of the social status and income level, market reforms have opened new opportunities to them. Today they are no longer bound to the soil nor prevented from diverting their assets away from field cultivation onto other more rewarding economic activities. By contrast, many of urban residents and factory workers who had benefited by their close relations with the SOEs and the government during the pre-reform era still remember their privileged income and social security

benefits they had enjoyed and today lament the loss of them. Given this background, it is understandable why urban residents have expressed stronger preferences for social welfare programs than those at the bottom of the society in rural areas.

Due to this relatively docile nature of Chinese farmers, the central government has been able to avoid critical political challenges from rural residents even when the central policy makers have largely excluded the vast majority of farmers from the newly designed social welfare system. Instead, the government concentrated on the new pension and health insurance schemes mostly for urban areas whereby a majority of the workers and residents believed that at least the most fundamental promises (such as wages, job security, and pension benefits for current retirees) should be kept. Thus, differences in political attitudes between urban and rural residents came into play, emboldening the Chinese government to build a dualist structure of PWC with discriminatory practices.

## **5.0 CONCLUSION AND LOOKING FORWARD**

### **5.1 RESEARCH SUMMARY**

In East Asia, state-led economic strategies put a priority on the export of labor-intensive manufactures throughout the industrialization period, leading governments and enterprises to strongly resist to social welfare expansion that would have ultimately increased labor costs. At the same time, export-oriented economic strategies provided incentives to expand access to public education, since human capital formation was crucial for economic development. As such, social policy in East Asia was not intended for social protection or redistribution itself but rather for the promotion of economic productivity. Scholars like Holliday theorized this pattern, presenting a model called “productivist welfare capitalism” (PWC). This model is predicated on the claim that, unlike advanced capitalist societies where social welfare generally embodies the successes of social democratic politics, East Asia’s social policy is strictly subordinate to the overriding policy objective of economic growth.

However, East Asian NIEs have also shown significant variation in institutional features of PWC. Indeed, despite their similar export-oriented economic strategies, East Asian welfare states adopted different patterns of social security programs. While social insurance schemes and social assistance programs are central to the welfare state in Japan, Korea, and Taiwan, compulsory savings schemes are essential components of the social security system in

Singapore, Malaysia and, Hong Kong. Meanwhile, China and Thailand have a system combining both social insurance and individual savings schemes supplemented by modest and means-tested public assistance programs.

Given the presumed variation, can we say that the so-called productivist welfare capitalism (PWC) is a principal model of East Asian welfare states? If the variation within the PWC world is systematic enough to identify sub-models, what are the characteristics of each sub-model? And what causal factors are behind the institutional variation of PWC? This study has discussed how productivist welfare states have evolved into three patterns: *inclusive productivist welfare* (IPW), *market productivist welfare* (MPW), and *dualist productivist welfare* (DPW).

First, IPW highlights the characteristic of “risk-sharing” and “fund-pooling” that can be achieved through social insurance schemes. By providing these inclusive social insurance benefits to a limited number of people—especially, government employees and industrial workers who were considered critical for economic development, IPW states could construct a social security system that protects important human resources while avoiding the government’s financial responsibility for the provision of social protection. Examples include Korea and Taiwan that have developed and expanded national pension and health insurance institutions since the industrialization period.

Second, the second type is MPW that is designed to create a social security system based on the “self-reliance” principle. Compulsory individual savings schemes like Singapore’s CPF, Malaysia’s EPF, and Hong Kong’s MPF are examples of MPW. Since social security benefits are exactly linked to individuals’ savings, there is neither risk-pooling nor deficits and therefore the government can be free from any financial commitments. This approach is believed to be the

best way to promote market-efficiency because MPW provides a socioeconomic environment favorable for the business sector and foreign investment.

Lastly, DPW is a model found somewhere between IPW and MPW, with a combination of both risk-pooling and self-reliance for single social security programs. In general, dualist strategies show two patterns of implementation. One is a multi-tiered social insurance program that consists of social funds and individual accounts. The other is that the government applies the program to different regions differently, particularly treating urban areas more favorably. DPW is likely to be adopted when the government aims to protect *productive* urban workers while leaving *less productive* rural residents dependent on individual savings or family support.

The cluster analysis in Chapter 2 confirms that the institutional variation of PWC is systematic and robust. Then what are the major factors that cause the cross-national variation? Why do some productivist welfare states enter a more inclusive way of PWC while some others develop a more market-oriented pathway? The first causal factor that I focus on is the levels of exposure to international markets that is believed to shape different economic structures and social security institutions. Although East Asian economies appeared similar in terms of their export-oriented strategies, the extent and form of their reliance on foreign capital and trade were remarkably different. While Singapore and Hong Kong were actively engaged in “market-conforming” developmental strategies by opening their financial markets and allowing foreign firms to take advantages of free markets in their economies, Japan, Korea, and Taiwan pursued “market-distorting” developmental strategies tightly controlling financial markets and promoted domestic firms under their guidance. Differences in economic openness created conditions for different types of PWC. The “market-conforming” economies adopted MPW to attract foreign investment whereas “market-distorting” economies implemented IPW to protect their key labor

force. Statistical data in Chapter 3 and the cases of Korea and Singapore support this explanation, confirming that the degree of economic openness and the corresponding strategies are closely associated with the institutional divergence of PWC.

The second factor is political pressure. In general, due to the need to secure a broad electoral base, politicians in democratic regimes are more responsive to the demand and political pressures for social protection of the citizens. As many empirical studies show, democratic regimes are more likely to have a stronger social policy commitment. For example, when democratic electoral competition was introduced in Korea and Taiwan, political pressure from the grassroots organizations became doubled, making the ruling parties be more attentive to the use and expansion of social insurance and public assistance programs as a political strategy to strength political legitimacy. As democracy and democratic governance became mature, the limited and selective benefits of IPW were extended to virtually the whole population. This trend was unambiguously observed, particularly after IPW economies were democratized in the late 1980s and experienced a devastating economic crisis in the late 1990s.

The three case studies in Chapter 4 provide illustrative pictures of the institutional divergence of PWC. As described in the chapter, the development of Korea's IPW was an outcome of economic strategies and political circumstances. During the 1960s and 1970s, the authoritarian Korean regime launched a series of IPW programs to facilitate its market-distorting strategy of economic development. The primary purpose of social insurance programs was to protect government employees, military personnel, and large-firm workers via social funds and risk-pooling. Since then, Korea has developed its institutional bedrock of PWC based on social insurance and public assistance. Yet the most salient watershed periods moment of Korea's IPW were the 1987 democratization movement and the 1997 economic crisis that accelerated the



expansion of population coverage of IPW benefits. These historical moments transformed Korea into a more salient IPW state. Particularly, immense political pressure from “critical citizens” and “dissatisfied democrats” came into play in support of a more comprehensive social security system and insurance benefits.

The second case is Singapore that developed a market-oriented PWC in East Asia. Indeed, Singapore’s social protection system has neither a meaningful pooling mechanism nor adequate benefits due to its high level of “commodification.” The centerpiece of Singapore’s MPW is the Central Provident Fund (CPF), a compulsory individual savings scheme which is a nearly pure defined-contribution (DC) system. The initiation of the CPF was the result of the colonial history and the geographical settlement that produced unique socioeconomic conditions for the state-building process in the 1950s and 1960s. As a tiny and resource-poor nation, Singapore had to find a way to survive in a global context that called for intense political and economic competitions. Due to the imperatives for survival, the emphasis of social policy was placed on the cutting of the severe unemployment, the expansion of primary health facilities and schools, and urban regeneration and slum clearance. Protective functions of social welfare other than these goals were simply considered unfit in the Singapore context. Indeed, its drastic liberalization of trade and financial markets determined economic conditions for “market-conforming” PWC. Furthermore, the PAP that seized the power and has maintained the ideological legitimization of its authoritarian liberalism since the Singapore’s independence consolidated the self-reliance principle through its tight control of the government, the society, and a series of repressive labor laws.

The last case examined in Chapter 4 is China’s DPW. China is a unique case in the productivist world of welfare capitalism. In many dimensions, China’s dualist approach is

distinguished from the prototypes of IPW (Korea) and MPW (Singapore). It reveals several interesting features. First, China's dualist approach mandates the combination of pooled funds and individual savings for pension and healthcare. This is a strategy to promote the market-oriented economic growth while preventing possible negative effects of marketization reform. The second feature is that different social security programs are applied to different regions creating remarkable urban-rural divisions. Although the Chinese government presumably aimed to develop an inclusive social insurance system that is redistributive and expansive, most of the new programs largely neglected the rural population. It was because pension and healthcare reforms were basically to protect industrial workers who are considered imperative for industrialization and economic growth. While the central government set forth regulations calling for urban employees to participate in pension and health insurance programs, those benefits were available to rural residents only when their village provided such coverage voluntarily. The Chinese government believes that the dualist approach of PWC is the best way to weave a social safety net while effectively transferring a greater portion of financial responsibility to individuals. This dualist pattern of PWC is largely due to the fact that China is still neither a fully developed capitalist society nor a democratic state. As one of the most dynamic economies in the world, China has a strong incentive for the liberalization of its traditional socialist system. But at the same time, the government should meet the needs of those who lament the loss of their privileged welfare benefits, which would otherwise be a significant threat to the political legitimacy of the CCP. This is why China has developed a dualist institution of DPW.

## 5.2 SUGGESTION FOR FUTURE RESEARCH

This research offers a useful theoretical lens through which to understand the development of PWC and its institutional variation systematically. Although the productivist thesis proposed by Holliday (2000) is tremendously useful in understanding the fundamental nature of East Asian welfare states, his explanation is not sophisticated enough to clarify the empirical realities of what we have observed in East Asia over the last several decades. Indeed, some critics have reminded that, “it is misleading to think in terms of one homogenous and overarching East Asian model” (White and Goodman 1998, 14). Of course, this argument does not mean that the PWC thesis is an invalid claim, but rather it urges scholars to improve the theoretical discourse of PWC and provide a more refined explanation. In this sense, my dissertation is meaningful and constructive in terms of its efforts to identify three broad patterns that have emerged within the productivist world.

Moreover, the statistical analyses and the three case studies of this dissertation provide a source for drawing important inferences regarding the welfare state development in the region because, as often pointed out, Holliday’s groundbreaking classification was rarely followed by further empirical examination that is necessary to convince the existence of a productivist regime (Lee and Ku 2007, 200). By providing theoretical support and empirical evidence, this study has contributed to the conclusion that there exist not only substantial variation among East Asian productivist welfare states but also close relationships between economic openness, political pressure, and the divergence of PWC. Although Ku and Finer (2007, 129) pessimistically expected that “there seems little likelihood of a cross-national longitudinal data set being developed in the near future,” I developed analytical frameworks and indicators derived from

theoretical perspectives and tested them empirically with a cross-national longitudinal data. The findings in this research are quite robust and noteworthy.

In addition, as Skocpol (1987) suggested, I included in my statistical analysis not only public assistance for low-income households but also, more importantly, institutional features such as the expansion of benefits and population coverage for major social security program (i.e., pension and healthcare). It is because a comprehensive understanding of welfare capitalism demands a careful examination of both expenditure-based variables and institutional features. This approach elucidates how productivist welfare institutions have evolved into what they are today.

Despite its theoretical and empirical significance, however, this dissertation cannot be regarded as sufficient for some reasons. First, my analysis centered on only pension, health, and public assistance because these three policy areas are commonly observed in any given economies. Despite the need of commonality and comparability, we cannot underestimate the significance of other policy areas that I did not incorporate in this study. A careful investigation on social insurance programs like unemployment, work injury, and housing programs therefore needs to be undertaken to see if my explanation is applied to these areas too. The extension to these welfare programs would be able to provide a more comprehensive picture of institutional varieties of PWC, allowing us to observe greater variation in social policy outcomes in East Asia.

Second, this dissertation examined Korea, Singapore, and China as three representative cases illustrating the features of IPW, MPW, and DPW, respectively. Even though three cases studies are a small number, the use of historical and descriptive explanations brings great benefits to us, especially, who are more familiar with large-N statistical methods. In this regard,

my approaches and findings should be compared and examined in an expanded set of case studies. I believe that Taiwan, Hong Kong, and Thailand, among others, can be considered as the next major case studies for IPW, MPW, and DPW, given the patterns of welfare state development in these countries.

The last suggestion is about another extension of the study, especially regarding other parts of the world. According to Rudra (2008), a group of Latin American countries privileges “commodification” of social welfare over “decommodification,” revealing some important productivist characteristics. Chile, Colombia, Costa Rica, Panama, and Paraguay, among others, fall into this category. If these countries formulate and implement social policy based on the belief that social welfare is a policy tool for economic development, it is necessary to examine and compare these cases through the analytical prism that I have presented in this dissertation. Without doubt, a geographically expanded set of statistical analysis and case studies will be a great contribution to the comparative welfare state literature.

## APPENDIX

### DESCRIPTION AND SOURCES OF THE VARIABLES USED IN CHAPTER 3

- IPW index: See the description in Chapter 2
- MPW index: See the description in Chapter 2
- Trade: Total trade (exports and imports) as a percent of GDP in current prices / Sources: Penn World Table 6.3 (2009); World Development Indicators (WB)
- Capital flows: Gross private capital flows measured as the absolute values of direct, portfolio, and other investment inflows and outflows that are recorded in the balance of payments financial account, calculated as a ratio to GDP in U.S. dollars / Source: World Development Indicators (WB)
- Democracy: Scale -10 to 10 (countries rating 5 and above labeled “democratic” and countries rating 4 and below labeled “nondemocratic”) / Source: Polity IV data (Marshall and Jaggers)  
<http://www.systemicpeace.org/polity/polity4.htm>
- GDP: GDP (constant 2000 US\$) / Sources: World Development Indicators (WB); Statistical Yearbook of Taiwan
- GDP per capita: GDP per capita (constant 2000 US\$) / Sources: World Development Indicators (WB); Statistical Yearbook of Taiwan

- Growth: Annual percent growth rate of GDP / Sources: World Development Indicators (WB); Statistical Yearbook of Taiwan
- Urbanization: Urban population as a percent of total / Sources: World Development Indicators (WB); Key Indicators (ADB)
- $\Delta$  unemployment: Change in unemployment rate measured as a percent of total labor force / Sources: World Development Indicators (WB); KILM 5th Edition (ILO); CIA World Factbook (Vietnam 2005~2008)
- Inflation: Annual percent of inflation measured by the consumer price index / Sources: World Development Indicators (WB); Statistical Yearbook of Taiwan; Statistical Yearbook of China (1978-1983)
- $\Delta$  exchange rate: Change in exchange rate to US\$ (annual average) / Source: Penn World Table 7 (2011)
- Population (65+): % of population (ages 65 and above) / Sources: World Development Indicators (WB); Statistical Yearbook of Taiwan
- Population: Total population / Sources: World Development Indicators (WB); Statistical Yearbook of Taiwan

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